

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

73
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

921

Nos.
71-1136
23,244
23,246

United States Court of Appeals
for the District of Columbia Circuit

FILED JUN 2 1971

Nathan J. Paulson
CLERK

HAIGHT & CO., INC., ET AL.,

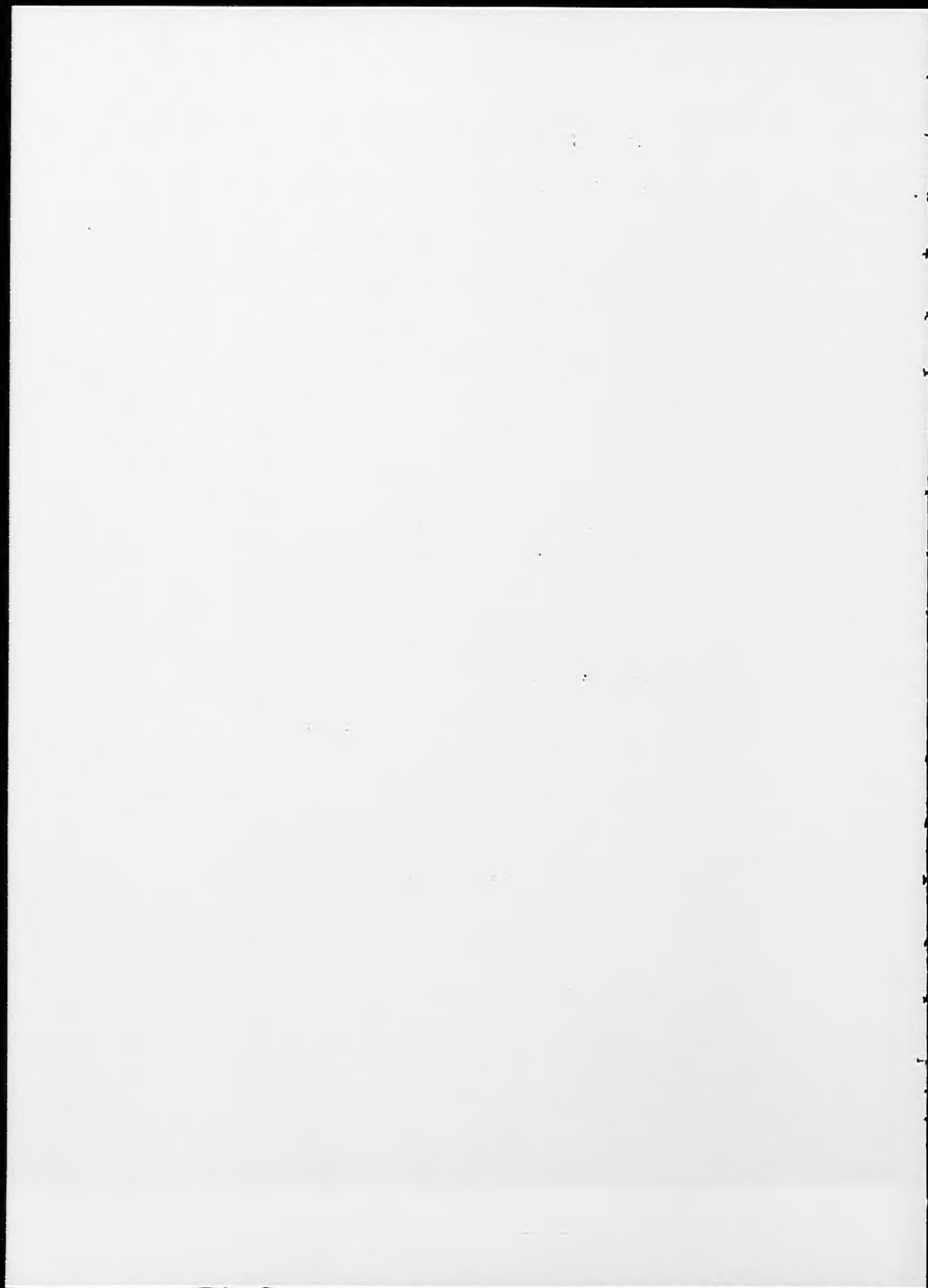
Petitioners,

-v-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

JOINT APPENDIX



UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

HAIGHT & CO., INC., et al.,	:	
	:	
Petitioners,	:	
	:	
v.	:	Nos. 71-1136
	:	23,244
SECURITIES AND EXCHANGE	:	23,246
COMMISSION,	:	
	:	
Respondent.	:	

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August 16, 1965

(To Chairman and all Commissioners)

We are writing this letter as counsel for Hodgdon & Co., Inc., which is presently the subject of an investigation by your Washington regional office to determine whether or not the firm and/or any of its employees has violated the Securities Act of 1933 or the Securities Exchange Act of 1934. In our capacity as counsel, we are familiar with the general course and trend of the investigation and of the matters and transactions into which the regional office has inquired. It is an established fact, that public notice or knowledge of an investigation of a registered broker-dealer can have a disastrous effect, and it is our concern that Hodgdon & Co. be protected against any adverse publicity in advance of the Commission's final disposition of the current investigation. Not only could the firm suffer a loss of clientele, but its good name and goodwill would be seriously affected -- perhaps permanently, and it would probably suffer a loss of valuable employees during the period between any public announcement and ultimate determination.

The firm's reputation and standing in the financial community, the character and reputation of its personnel, the history of its operations and particularly recent changes in its management and operations render public proceedings unnecessary whether they be judicial or administrative. We do not believe that the actions and practices with which the staff seems to be concerned were violative of any law or regulation of any administrative agency. But whether they were or not these areas of concern relate to events occurring prior to changes in the firm's management, and new management has corrected any actions or practices which conceivably might have been criticized in earlier stages of the firm's operations. In our judgment, the firm's operations now conform to and even go beyond required standards of fair dealing between a broker-dealer firm and its clients.

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We set forth below in more detail the facts and circumstances concerning the firm and its operations which, in our opinion, clearly justify the holding of private, rather than public proceedings (if any proceedings are to be brought against the firm). We believe that these facts and circumstances conform with the Commission's statements of its criteria for private, rather than public proceedings.

History of the Firm

The firm was founded in 1955 and has continually been in business since that date. It engages generally in the securities business, buying and selling for the account of customers both listed and unlisted securities and mutual funds. From time to time it has acted as an underwriter of securities of industrial corporations and has also acted as an underwriter of real estate syndications. The firm is a member of the National Association of Securities Dealers (NASD) and the Philadelphia-Baltimore Stock Exchange and through this affiliation is also a member of the Boston and Pittsburgh Stock Exchanges. The firm complies with all requirements of such exchanges and all of the rules and regulations of your Commission. Except for a brief period during the yearly years of its operations, when for inadvertent failures to comply with technical regulations the firm was disciplined by the NASD and Philadelphia-Baltimore Exchange, the firm has never been the subject of any disciplinary action by any regulatory authority, and at no time has there been any disciplinary proceeding in which it has been accused of taking advantage of its customers in any way. The firm has long since adopted procedures correcting and preventing the technical infractions of rules which occurred during the early period of its existence. Moreover, in 1964, the present officers and directors acquired a two-third majority of the firm's outstanding stock, and control of the management and policies of the firm. The new management has been meticulous in its efforts to comply with all requirements of regulatory agencies and with the highest standards of the industry.

The firm presently has approximately 13,000 customers accounts, of which about 10,000 may be considered to be active. No margin accounts for customers are maintained by or with the firm. Since the firm's policy militates against "trading," discretionary accounts have never been encouraged and even in those cases where discretionary authority was granted, such authority was rarely exercised. In October, 1964, new management issued a written policy statement advising all registered representatives that discretionary accounts would not be allowed, excepting only those where the prohibition would work to a client's disadvantage; in those cases the reasons for exception must be submitted in writing and approved by the Board of Directors. It is not contemplated that such approval will be granted

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except where the client will be absent from the country for an extended period of time.

As will be set forth more fully below, the firm never has operated in the manner ascribed to so-called "boilerships." The firm's policy prohibits the sale of securities to unknown customers over the telephone. Telephone solicitation is confined to a general presentation of the firm's services and a request for a personal interview with the client either at his office or residence or at the office of the company. When practicable, the firm prefers that such interviews take place at its offices.

Officers, Directors and Personnel

As set forth above, the firm is controlled presently by its officers and directors who acquired collectively a majority of its stock in July, 1964. All of such officers and directors (with the exception of W. Lyles Carr and the former majority stockholder whose influence and participation in management has been substantially reduced in the last two years) are college graduates. No disciplinary proceedings have ever been instituted against any of the officers and directors who constitute the present controlling group and are actively engaged in the management of the firm's operations. In our opinion, the reputations and integrity of such officers and directors are beyond reproach. A public proceeding against the firm would most unjustly reflect on the character of the present officers and directors.

The firm employs 80 people of whom 55 are registered representatives. The great majority of the registered representatives are college graduates and none has ever been the subject of any disciplinary action by any regulatory authority. Prior to engaging in any selling activities, such representatives are given a comprehensive course in the purposes and methods of operation of the firm and the rules and regulations of all regulatory authorities. By written memoranda and frequent meetings, registered representatives are informed of and advised against improper selling practices, such as exaggerated claims of earning power or market appreciation. Correspondence between registered representatives and customers is regularly checked by senior officers which insures that no improper representation has been made to the firm's customers.

All purchase and sales tickets are examined and initialled at the close of each day by an officer of the firm. On March 2, 1965, new management issued a written memorandum of policy providing for periodic review of every account from the standpoint of activities, commitment in speculative securities, and adherence to a "ratio system" of investment.

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Since its inception the firm has had comparatively few expressions of dissatisfaction concerning the activities and representation of its registered representatives. All written complaints are examined by the firm's officers and when warranted, adjustments are made with the customer.

We believe that the firm's supervision of its registered representatives is and has been in complete conformity with all rules and regulations of your Commission and of the NASD. Of course, some infractions may be inevitable in a firm with a large number of customers and representatives, but we believe that such cases are rare.

Method of Operation

From its inception the firm has emphasized in its advertisements and radio and television messages the importance of financial planning. Customers are interviewed by registered representatives and such representatives are required to obtain, or at least attempt to obtain, a completed "Confidential Data Sheet," a copy of which is attached. As will be seen, this form provides information pertaining to the client's occupation, age, number of dependents, financial objectives, the amount of income which is expected to be derived from social security benefits, pensions and insurance, the value of insurance, annual premium, the nature of real estate holdings, the amount of savings in cash and bonds, the nature of security investments, and other pertinent information. Only about 40% of the firm's clients have been willing to subject themselves to the discipline of completing such a form. If an investor refuses to supply this information and insists on the acquisition of specified individual securities of his own choosing, such orders are marked "unsolicited." If the order is not so marked, it is deemed by the firm to be a recommendation of the representative.

The ratio of investments recommended by the registered representative after examination of the Confidential Data Sheet is checked by an officer of the firm to determine the suitability of the particular suggestions for the individual involved, and as set forth above, adherence is reviewed periodically. The firm is of the opinion and has in the past followed within flexible limits, the view that a balance of assets should include, depending upon the particular case, sources of fixed income (such as pensions, social security benefits and insurance) and investments in mutual funds, since in the firm's opinion the constant portfolio supervision such funds offer meets the needs of most investors. In the past the firm has also recommended real estate syndications in which it has acted as underwriter, and has suggested for speculative investment, securities of companies which it was distributing as underwriter or otherwise.

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However, in nearly every case where the client has submitted himself to financial planning, speculative securities have constituted not more, and usually much less, than 20% of the total mix of investments recommended to a customer. In certain cases, when indicated by the objectives and income of the investor, the firm may offer participation in an oil and gas development program. Such programs, however, are offered only to persons in relatively high income tax brackets. In cases of investors of substantial wealth, the firm may also advise the employment of an investment advisory firm for advice on and constant supervision of the client's portfolio. Investment advisory firms so recommended do not pay any compensation whatever to the firm for such recommendations. The firm also employs a specialist in estate planning who is available for a review of the total financial program to be offered to certain clients.

Substantially all of the securities recommended to customers by the firm have been issues registered with the Commission under the Securities Act of 1933, and in accordance with that Act, the customer is furnished a prospectus of each issue he acquires. This is true not only of mutual funds, but of the real estate syndications which the firm has offered and of the oil and gas exploratory programs. Few private placements have ever been made by the firm and none are contemplated by the new management.

Prior to 1964 when the already described change in management of the firm occurred, the then dominant stockholder had an interest in certain of the real estate syndications offered by the firm, a minority interest in a distribution company for one of the mutual funds and a less than 1% interest in the publicly owned operating company sponsoring oil and gas programs offered by the firm.

The Report of the Commission's 1962 Special Study of Securities Markets (Part I, Chapter 3, page 261) raised the question whether the firm's representatives should have made verbal disclosure of such interests to customers, particularly those who came to the firm for specialized financial planning. But as disclosed by the transcript of the hearing of the Special Study (May 10, 1962, pages 583, et seq.), these self-interests were disclosed in the prospectuses concerning the particular investments or were of such insignificant character that the Commission's rules did not even require that they be disclosed in the prospectus.

The new management, however, has adopted a policy since 1964 of not offering to investors securities of any company in which any of its officers or directors has any direct financial interest, other than that of underwriter, which interest is of course disclosed on the first page of the prospectus. In recent years, moreover, underwritings by the firm have

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declined in number and the firm, like most reputable broker-dealers, will no longer underwrite shares in small, unseasoned, industrial companies. In realty offerings, the firm now deals in shares of real estate investment trusts, rather than limited partnership participations in real estate syndications. This has been made possible by an amendment to the Internal Revenue Code which allows liquidity of interest while preserving the inherent tax advantages of ownership of real property.

We believe the firm's advertising of its financial planning programs has always sufficiently disclosed the fact that the recommended investments would include mutual funds as well as listed securities of merit, real estate syndications and, in proper cases, oil and gas programs. Since the advent of the new management in 1964 the firm's advertising, whether in pamphlet form or on radio or television, has been revised to make even more clear that these types of securities are fundamental in financial planning programs advocated by the firm. Moreover, in compliance with NASD requirements, all of the firm's literature, advertising and radio commercials are reviewed and approved by that Association.

Trend of the Investigation

The investigation cannot and does not indicate that the firm has ever engaged in so-called "boilershop" activities. There were no extravagant claims of prospective earnings and appreciation. The securities offered by the firm, with the exceptions stated above, have all been prospectus issues consisting primarily of mutual funds, real estate syndications and oil and gas programs. The staff's concern seems to be with a possible necessity for increased oral disclosure of self-interest or other factors because the firm describes itself as specializing in individualized financial planning. The staff seems to have the view that use of the term "individualized financial planning" may impose a special disclosure obligation beyond that fulfilled by the prospectus.

Customers who have been interviewed by the staff and have voluntarily informed the firm of the nature of such interviews, have not questioned their transactions nor expressed any grievances to the firm. The firm now has approximately 10,000 active customer accounts. To our knowledge, the staff has examined by personal interview only about twenty-three of such customers. As the Commission knows, the interrogation of witnesses in an investigation is not subject to cross-examination, but we are certain that if a registered representative

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were criticized by an investor, the records would show a quite different version of the facts.

For example, the staff has examined a Mrs. D, a customer of the firm. We do not know, of course, the nature and character of Mrs. D's testimony, but the facts as we have them from the documents and the registered representative who handled Mrs. D's account, are as follows:

The representative has been a friend of Mrs. D and her family for a number of years. He is particularly friendly with Mrs. D's son, a friendship which goes back many years. In 1961 Mrs. D requested the representative to examine her investments with a view to such changes as might be necessary to increase her aggregate yield. She was then 56 years old. Her portfolio consisted of listed securities and bank stocks with an aggregate market value of approximately \$166,000. The yield was approximately \$6,000 per year, or about 4% of the value of her investments. Virtually all of this income was fully taxable. The representative suggested to Mrs. D that from time to time securities in her portfolio be sold, particularly those securities which seemed to be fully appreciated and to have little prospects of increased yields. Over a period of a year or so, approximately \$102,000 of her 1961 portfolio was liquidated. At the conclusion of this liquidation, retrospective examination of her previous holdings revealed that had these securities not been liquidated, their aggregate market value would have declined approximately \$30,000.

Against the recommendation of the firm's representative, approximately \$40,000 of the cash realized from the liquidation was invested by the customer in a magazine enterprise organized by her son. All of this was lost. Twenty-thousand dollars was invested in the First National Real Estate Investment Trust, which is quoted at or above her investment and upon which distributions of approximately 7.2% of the investment have been and are continuing to be made; the distribution includes a return of capital which is not subject to income tax. Approximately \$20,000 was invested in real estate syndications offered by the firm, some of which have declined in yield from the time of original offering. Nevertheless, 1964 distributions on these investments were approximately \$1,200. Eighteen thousand dollars was invested in an Apache Corporation oil and gas program for the purpose of reducing taxes caused by capital gainst on the liquidation of certain of the securities. Apache Corporation, a listed company, is the largest sponsor of oil exploration programs available for public participation.

Mrs. D employed a certified public accountant^{ant} with whom the registered representative discussed general investment objectives as well as specific changes in investments. Mrs. D also participated in the determination of

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these general objectives and was consulted with respect to each investment transaction. In September of 1962 in a letter to the representative, she wrote "my primary reason for making such drastic changes in my portfolio was for additional income." Apparently she felt that the representative had served her interests well, for in early 1963 she wrote: "Just wanted you to know that I do appreciate all your efforts in building up my estate."

Subsequently Mrs. D complained about the assessments on her Apache Corporation 1961 Canadian Oil Program. Unfortunately these assessments were inadequately forecast by the prospectus. However, since assessments were made only for step-out wells in proven areas, they were directly related to the success of this particular program. At one point she offered to sell her interest in this program back to Apache Corporation. At the time of the offer she had invested \$18,000 (\$10,700 after tax deduction). The representative, having reason to believe that eventual income from this program would exceed \$30,000, discouraged Mrs. D from accepting Apache's buy-back offer, which computed on a formulary basis was \$14,385. Her attorney concurred. Mrs. D finally accepted this advice and retained her oil and gas investment from which she receives approximately \$125 per month.

Obviously there may be differing judgment as to the wisdom and reasonableness of particular recommendations for shifts of investments, but each of these shifts for Mrs. D were believed to be commensurate with Mrs. D's stated objectives and indeed have tended to fulfill them. It should be noted that despite Mrs. D's loss of \$40,000 on the investment in her son's magazine, the 1964 distributions from the portfolio remaining were approximately equal to her distributions from investments at the time she first became a customer of the firm.

Another example is the case of Miss G, a doctor of medicine specializing in anesthesiology. She was referred to a registered representative of the firm by her sister. She was 35 years old, unmarried, had a 72-year-old mother with a sizeable independent income and could anticipate some inheritance from her. Miss G was earning approximately \$15,000 per annum in 1960. Her earnings have increased annually and her practice now nets her approximately \$30,000 per year.

Miss G had a substantial equity in her home and various insurance policies which protected her against health and accident hazards. Shortly before consulting the firm she made an advance payment of \$40,000 on an annuity policy issued by Maryland Life Insurance Company which was to accrue interest at the rate of 3-1/2% per annum and produce \$359 per month at age 60. Miss G also had approximately \$25,000 invested in American Smelting and approximately \$5,000 in American Telephone and Telegraph.

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She estimated that she could save for investment purposes \$300 to \$400 per month. Her investment objective was stated to be early retirement with an income of approximately \$1,000 per month.

In view of her age, earning capacities and savings potential, the registered representative recommended that she liquidate the annuity policy as unsuitable to her position or objective and invest approximately \$33,000 of the proceeds in the outright purchase of shares of two mutual funds emphasizing long-term growth as their investment policies. It was also recommended that she augment her holdings in these funds by additional investments of \$100 per month in each of the funds. As her income and, hence, her tax bracket increased, the registered representative recommended that she invest funds in oil and gas programs offering certain and known tax advantages. It was also suggested that she gradually sell her stock in both American Smelting and A T & T. The representative believed that American Smelting had reached its full growth potential and that A T & T was selling at an inflated price. Moreover, it was felt that an investment in a diversified, professionally managed equity portfolio, i.e., the two proposed mutual funds, would be a more suitable investment than the shares of two companies. It was also proposed that she place a total of approximately \$20,000 in real estate syndications sponsored by the firm with a view toward reinvesting the tax-sheltered yield in more mutual fund purchases. The representative also believed that Miss G's yearly earnings made a certain amount of speculation desirable. Miss G gave the representative discretionary authority, but this authorization was never used and every investment involving significant sums of money was discussed with her prior to an investment commitment.

Although most of the speculative securities recommended by the registered representative have depreciated in value since Miss G acquired them, and at least one became valueless (and was treated as a tax offset against capital gain), we believe that the representative made these recommendations out of a sincere conviction that they would lead to the attainment of Miss G's investment objectives and were reasonable and suitable under the circumstances of her age, profession and income.

Some of the real estate syndications in which Miss G holds an interest are producing less yield than anticipated, but the real properties are located in growth areas and present vacancies would appear to be temporary. The mutual funds in which most of Miss G's money has been placed have performed well. Her mutual fund holdings had a market value of \$49,000 as of January of this year against a cost basis of \$32,500.

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In the event the staff should rely on cases such as those above as a basis for recommending a proceeding against the firm, it would appear that the facts here are very much in dispute. Under such circumstances, the Commission has customarily held private proceedings, if it has held any proceedings at all. See II Loss, Securities Regulation, Little Brown and Co. (1961) at page 1335.

The staff has also seemed concerned with the suitability of particular investments for particular customers. We believe the staff's approaches and their legal theses, if sustained, constitute departures from generally accepted standards now prevailing in the industry. We believe the practices, procedures and disclosures made by the firm and its registered representatives to investors fully comply with existing standards. The firm, of course, cannot and does not object to cooperating toward the evolution of greater and more exacting standards of conduct between a broker-dealer and his clients. However, if such standards are to be adopted by way of an adjudicative proceeding, such proceeding should be held privately in the interest of fairness to the firm which becomes a sounding board for evolving such standards. This is especially true where the investigation of this firm shows no evidence of the gross fraud and complete disregard for the interests of investors which is typical of the firms against which public proceedings have been conducted by the Commission.

The Absence of a Public Interest in Public Proceedings

The Commission has publicly stated that a material factor in its determination whether to conduct disciplinary proceedings publicly or privately is the degree to which nondisclosure of proceedings may prejudice investors whose possible causes of action against the firm may be eliminated by the expiration of the statute of limitations during the private proceedings. The great majority of the transactions and practices examined by the Commission's staff in the investigation took place more than three years ago, long prior to the change in the firm's management in 1964.* Thus, the statute of limitations set forth in Sec. 13 of the Securities Act on causes of action created by the statute itself has already expired. It is true that the courts

*/ The order of investigation in this matter refers to six offerings made by the firm, four of which were made and completed prior to the close of 1962. The other two were made and completed more than one year ago while the firm was still under control of prior management. The latter two offerings have, in our judgment, maintained their value and are presently worth at least the offering price. The firm has received no complaints from any customers in respect to these offerings.

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have held that actions under Section 17(a) of the Securities Act and 10(b) of the Securities Exchange Act and Rule 10b-5, promulgated under such Act, have the same statute of limitations as that prevailing for common law actions in fraud and deceit in the jurisdiction in which the alleged fraud occurred. We doubt strongly, based on our knowledge of the investigation's course, that actions exist under these statutes or at common law. In any event, if a proceeding is to be brought in this matter, the firm stands ready to stipulate with the Commission to waive any rights which it may have to assert the statute of limitations in any civil actions brought against it for any reasonable period the Commission may suggest after the Commission has rendered any decision in the proceeding. We believe, therefore, that under the circumstances there can be no justification for a public proceeding on the theory that private proceedings may cause the loss of the right to investors to commence actions against the firm because of the statute of limitations.

We note that the Commission has conducted private proceedings in cases in which serious accusations have been directed against a broker-dealer. See In the Matter of Axe Securities Corporation; E. W. Axe and Co., Inc., Securities Exchange Act Release No. 7442 (October 14, 1964); Matter of Wayne Jewell Company (Securities Exchange Act Release No. 7235 (1961), in which charges of sale of unregistered securities and fraud and manipulation were asserted against a broker-dealer. We are also aware that a private proceeding is presently being conducted against a very prominent member of the New York Stock Exchange for alleged fraudulent sale of speculative securities notwithstanding detailed publicity concerning such activities contained in the Commission's Report of its Special Study and the publication of the proceedings and judgment of the NASD against such firm prior to the institution of the Commission's proceedings. We think these decisions were correct, and if any proceedings are to be conducted against Hodgdon & Co., under principles of equal protection, it is entitled to similar treatment, i.e., a private proceeding.

Conclusion

On the basis of all the foregoing considerations, we are convinced that no proceedings are necessary for the correction of any acts and practices of the firm. Such acts and practices which may have been subject to criticism in the past have been fully corrected by present management and there is no need for remedial action on the part of the Commission.

Indeed, we believe that internal safeguards created by new management, even prior to the formulation and distribution of the NASD bulletin on supervision, places this firm on the highest level of ethical practices.

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The firm now employs, at its own expense, independent, outside professionals, such as auditors and engineers to evaluate all proposed real estate offerings and on their advice has rejected proposals when acceptance and placement would have produced large underwriting fees. New management has also instituted a unique method of policing switches from mutual funds to other mutual funds or different types of investments. Whenever the trading department receives a sell order for mutual funds without an accompanying direction to send the proceeds directly to the customer, the president of the firm is advised of the proposed transaction before it takes place. He then telephones the registered representative to ascertain the reason for sale. If it appears that the customer intends to reinvest the proceeds in another mutual fund or any other commissionable investment, the customer is asked to furnish a written statement acknowledging his awareness that the transactions will involve payment of additional commission, and that such transactions are at his direction. During regular weekly meetings, representatives are lectured on legal requirements, ethical standards, and their responsibilities. Outside experts, such as tax lawyers and personnel of the Internal Revenue Service, give lectures on specialized topics. New management now retains a prominent research firm to provide research on listed securities. These policies and practices and those mentioned earlier are only a portion of the changes adopted by the new management to assure the firm's adherence to the highest standards in every facet of its operations.

We believe that since disciplinary proceedings against broker-dealers are essentially remedial and not punitive in character and purpose, the facts set forth herein support a conclusion that no proceeding is necessary. We assure you that the firm has no objection to evolving standards of behavior for broker-dealers in respect of their customers and stands ready to, and has always complied with, all such ascertainable standards and with all of the rules and regulations of the Commission and other regulatory agencies. However, if the Commission believes that action is necessary to formulate additional or new standards of practice for broker-dealers, a private proceeding could accomplish this objective with minimum injury to the firm.

If the Commission is disposed to institute a proceeding against the firm, private or public, we respectfully request pursuant to Section 6(a) of the Administrative Procedure Act ^{*}/ that we be granted the right to be heard

^{*}/ Section 6(a) provides: "So far as the orderly conduct of public business permits, any interested person may appear before any agency or its responsible officers or employees for the presentation, adjustment, or determination of any issue, request, or controversy in any proceeding (interlocutory, summary, or otherwise) or in connection with any agency function."

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in oral argument against the institution of such a proceeding, or in the alternative, against the conduct of such proceeding publicly.

Respectfully submitted,

DICKSTEIN & SHAPIRO

By _____
General Counsel

Harry Heller, Special Counsel

cc: Mr. Ralph S. Saul
Director, Division of Trading and Markets

Mr. Alexander J. Brown, Jr.
Regional Administrator

Mr. Paul F. Leonard
Assistant Regional Administrator

FINANCIAL PLANNING WORKSHEET

NAME _____

DATE OF BIRTH _____ AGE _____

ADDRESS _____

TELEPHONE _____

OCCUPATION _____

POSITION _____

BUSINESS ADDRESS _____

TELEPHONE _____

DEPENDENTS:

Name	Relationship	Date of Birth	Life Insurance
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

FINANCIAL OBJECTIVES:

Retirement:

Monthly Income Needed \$ _____

\$ _____ Social Security

_____ Pension

_____ Other

\$ _____ Sub-Total

_____ Needed from investment sources.

\$ _____ Total monthly income necessary for proper retirement.

Other:

\$ _____ Total other funds needed.

COMMENT:

Total Capital Required: \$ _____

INSURANCE:

	Date Purchased	Amount	Type	Annual Premium	Company	Insurance Status
Life	_____	_____	_____	_____	_____	_____
	_____	_____	_____	_____	_____	_____
	_____	_____	_____	_____	_____	_____
	_____	_____	_____	_____	_____	_____
Other	_____	_____	_____	_____	_____	_____
	_____	_____	_____	_____	_____	_____

REAL ESTATE:

Description	Cost	Mortgage	Mortgage Yrs. remaining	Present Value
	\$	\$		
	\$	\$		
	\$	\$		
	\$	\$		

Gross Income per year from Real Estate \$
 Net income per year from Real Estate \$
 Tax status of Real Estate Cash flow \$

ASSETS:

INCOME:

Cash and/or Bank \$
 Gov't. Bonds \$
 Savings & Loan \$
 Other \$
 Total \$
 Salary \$
 Total \$
 Savings per month \$
 % Tax Bracket

INVESTMENTS: (Use separate sheet if necessary)

No. of Shares	Name of Company	Date	Cost		Present Value	
			Per Sh.	Total	Per Sh.	Total

MISCELLANEOUS:

Have you made a Will? Is there a possible inheritance?
 In the event of premature death, what amount of money per month would your wife or other dependents need? \$
 Do you contemplate substantial charitable contributions? \$
 Have you considered the use of Trusts in your Financial Planning?

ADDITIONAL DATA:

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

MAR 2 1966

In the Matter of
HODGDON & CO., INC. (8-8427)

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

ORDER FOR PUBLIC PROCEEDINGS
PURSUANT TO SECTIONS 15(b) AND
15A AND 19(a)(3) OF THE SECURITIES
EXCHANGE ACT OF 1934

I

The Commission's public official files disclose that:

A. Hodgdon & Co., Inc. (registrant), a Delaware corporation, has been registered as a broker-dealer pursuant to Section 15(b) of the Securities Exchange Act of 1934 (Exchange Act) since May 1, 1960 and is still so registered. Registrant is the successor to Hodgdon & Co. which registration became effective on February 7, 1956.

B. James F. Haight (Haight) is the president, a director, and a 10% or more stockholder of registrant. A. Dana Hodgdon (Hodgdon) was Chairman of the Board, treasurer, and 10% or more stockholder of registrant. Burton Kitain (Kitain), W. Lyles Carr, Jr. (Carr), David M. Adam, Jr. (Adam) and James W. Harper III (Harper) are vice-presidents and directors of registrant.

C. Registrant is a member of the National Association of Securities Dealers, Inc. (NASD), a national securities association registered pursuant to Section 15A of the Exchange Act.

D. Registrant is a member organization of the Philadelphia-Baltimore-Washington stock exchange and other exchanges.

II

As a result of an investigation, the Division of Trading and Markets has obtained information which tends to show and it alleges that:

A. During the period from approximately May 1957 to date hereof, Homer E. Davis (Davis) has been a salesman for registrant. During the period from approximately May 1960 to date hereof, Robert F. Kibler (Kibler) has been a salesman for registrant. During the period from approximately March 1960 to July 1961, Louis S. Amann (Amann) was a vice-president and director of registrant and thereafter from October 1961 to approximately October 1965 was a salesman. During the period from approximately August 1959 to January 1963, James L. Roper (Roper) was a salesman for registrant. During the period from approximately November 1961 to approximately November 1964, Harvey E. Baskin (Baskin) was a salesman and from approximately January 1963 to approximately November 1964 was also assistant to the then president (Hodgdon) of registrant.

B. During the period from approximately May 1960 to June 1964, registrant, Hodgdon, Haight, Carr, Harper, Adam, Kibler, Davis, Kitain, Roper, Baskin, Amann, hereinafter sometimes collectively referred to as respondents, singly and in concert, wilfully violated and aided and abetted wilful violations of Section 17(a) of the Securities Act of 1933 (Securities Act) and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder in that respondents in connection with the offer, sale and purchase of securities, directly and indirectly, employed devices, schemes and artifices to defraud, obtained money and property by means of untrue statements of material facts and omitted to state material facts necessary to make the statements made in the light of the circumstances under which they were made, not misleading and engaged in transactions, acts, practices, and a course of business which would and did operate as a fraud and deceit upon purchasers and prospective purchasers of securities. As a part of the aforesaid conduct and activities, respondents, among other things, would and did:

- (1) permit, engage and arrange for the employment as salesmen for registrant of individuals who had little or no prior experience, training or qualifications as securities salesmen and permit, encourage and arrange for registrant's salesmen to advise customers regarding their finances including securities investments, real estate, taxation, trusts and wills, oil and gas, and insurance without suitable training in such fields and without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business;
- (2) induce inexperienced and unsophisticated customers to repose complete trust and confidence in them causing such customers to believe that they would act in their best interests in connection with all purchases and sales of securities;
- (3) cause such customers to believe that respondents had special skill, knowledge, and experience in financial planning, including securities investments;

- (4) induce customers, without regard to such persons' financial needs and objectives, to sell seasoned securities out of their investment portfolios and reinvest the proceeds in unseasoned and speculative securities in which respondents had direct and indirect interests;
- (5) fail to disclose to such customers the respondents special interests in certain transactions, namely, registrant's commissions, charges, and profits on securities transactions;
- (6) cause such customers to retain their trust and confidence in respondents by means of lulling letters and oral representations that they were better off because of the financial advice given by respondents, when, in fact, such customers had suffered losses or were no better off than before dealing with respondents;
- (7) engage in the distribution and sale of speculative and unseasoned securities without first having made reasonable and diligent inquiry as to the true nature and worth of these securities, although on notice of facts and circumstances which made such inquiry essential and which inquiry, if made, would have revealed the background of the issuers, the circumstances surrounding their organization, and the history of these issuers as to their operations, earnings, dividends, current financial condition and other similar matters;
- (8) engage in the distribution and sale of securities to customers without disclosing their failure to have made the inquiries described above and their failure to obtain and disclose such material adverse information;
- (9) endeavor by the use of high pressure selling efforts to place customers in a position where they were asked to make hasty decisions to buy securities upon the basis of incomplete, untrue, deceptive and unsubstantiated representations;
- (10) offer to sell, sell, and deliver after sale, the securities of U. S. Infrared Corp., (Infrared), Paragon Electrical Manufacturing Corp., (Paragon), and Data Processing Corp., (DPC) when no registration statement under the Securities Act had been filed or was in effect with respect to such securities;
- (11) while engaged in the distribution of Infrared, Paragon, DPC and other securities and acting as a broker-dealer fail to send confirmations of certain of such transactions to customers at or before the completion of each such transaction;
- (12) participate in the operations of a securities selling organization in which the salesmen without suitable training in the standards of conduct required of those engaged in the securities business

were permitted and encouraged to offer and sell securities to customers and fail to reasonably supervise salesmen who were subject to their supervision, with a view to preventing violations of the statutes, rules and regulations administered by the Commission.

- (13) fail to make entries on the books and records of registrant for the purpose of concealing all or certain of the activities in paragraphs (1) through (12) above; and
- (14) make untrue, deceptive, and misleading statements of material facts and omit to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading with regard to all or certain of the securities of Infrared; Paragon; DPC; Van Pak, Inc.; Roseville Detroit Limited Partnership, and Apache Canadian Oil & Gas Program 1961, concerning, among other things:
 - (a) a rise in the price of such securities;
 - (b) the earnings and financial condition of the issuers;
 - (c) the use of the proceeds by the issuers;
 - (d) the uniqueness or superiority of the products;
 - (e) the rate of return from these securities;
 - (f) the quality and safety of the securities;
 - (g) the future prospects of the issuers;
 - (h) the contracts held by the issuers;
 - (i) the management of the issuers;
 - (j) the market value of the securities;
 - (k) the registrant's recommendation of such securities;
 - (l) the future assessments on the securities;
 - (m) the activities described in paragraphs (1) through (13) above;

and other statements, representations, and omissions of similar object and purport.

C. In carrying out the activities and course of business described in paragraph B of Section II above and during the period of time described therein, registrant, Hodgdon, Haight, Kitain, Carr, Adam, Davis, Amann, and Roper, singly and in concert, wilfully violated and aided and abetted wilfull violations of Sections 5(a) and 5(c) of the Securities Act and Sections 15(c)(1) and 17(a) of the Exchange Act and Rules 15c1-4 and 17a-3 thereunder in the manner and means more fully described in the referenced subparagraphs:

Sections 5(a) and 5(c)
of the Securities Act

Subparagraph (10)

As to registrant, Hodgdon, Haight, Kitain, Carr, Davis, Amann, and Roper only:

Section 15(c)(1) and Rule 15c1-4
of the Exchange Act

Subparagraph (11)

Section 17(a) and Rule 17a-3
of the Exchange Act

Subparagraph (13)

D. During the period of time referred to in paragraph B of Section II hereof, registrant, Hodgdon, Haight, and Carr, singly and in concert, wilfully violated and aided and abetted wilful violations of Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder in that while engaged as a broker-dealer and acting as underwriter of Southeastern Mortgage Investors Trust on a "best efforts" basis in the distribution of such securities they failed to promptly transmit funds to the issuer or establish an escrow bank account in which to deposit funds so received.

E. During the period of time referred to in paragraph B of Section II hereof, registrant, Hodgdon, Haight, Kitain, Carr, Adam, Harper, and Amann, singly and in concert, wilfully violated and aided and abetted wilful violations of Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder in that they failed to promptly amend registrant's application as a broker-dealer to disclose changes in registrant's officers, directors, and holders of 10% or more of its stock.

F. While engaged in the acts, practices and course of business described in paragraphs B through E of Section II, respondents, directly and indirectly, made use of the mails and means and instruments of transportation and communication in interstate commerce, and of the means and instrumentalities of interstate commerce, and effected the transactions mentioned otherwise than on a national securities exchange.

III

In view of the allegations made by the Division of Trading and Markets the Commission deems it necessary that public proceedings be instituted to determine:

(A) Whether the allegations set forth in Section II hereof are true and in connection therewith to afford respondents an opportunity to establish any defenses to such allegations; and

(B) What, if any, remedial action is appropriate in the public interest pursuant to Sections 15(b), 15A and 19(a)(3) of the Exchange Act.

IV

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof be held at a time and place to be fixed, and before a hearing officer to be designated by further order, as provided by Rule 6 of the Commission's Rules of Practice (17 CFR 201.6).

IT IS FURTHER ORDERED that each party file an answer to the allegations contained in the order for proceedings within 15 days after service upon him of said order as provided by Rule 7 of the Commission's Rules of Practice (17 CFR 201.7). If any party fails to file the directed answer or fails to appear at a hearing after being duly notified, such party shall be deemed in default and the proceeding may be determined against such party upon consideration of the order for proceedings, the allegations of which may be deemed to be true as provided by Rules 6(e) and 7(e) of the Commission's Rules of Practice.

This order shall be served upon Hodgdon & Co., Inc., A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis, Robert F. Kibler, Louis S. Amann, James L. Roper, and Harvey E. Baskin personally or by certified mail forthwith.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision upon this matter, except as a witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule-making" within the meaning of Section 4(c) of the Administrative Procedure Act, it is not deemed to be subject to the provisions of that section delaying the effective date of any final Commission action.

By the Commission.

Orval L. DuBois
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC.

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

File No. 3-533

MOTION TO DISMISS

Come now Hodgdon & Co., Inc., A. Dana Hodgdon,
James F. Haight, Burton Kitain, W. Lyles Carr, Jr.,
David M. Adam, Jr., James W. Harper, III, Homer E. Davis,
and Robert F. Kibler, respondents herein, and move for an
order dismissing the order for public proceedings in the
within case on the grounds that:

(1) The Commission's refusal to conduct
these proceedings privately and to hear oral
argument on that issue constitutes a violation

of due process of law and Section 6(a) of the Administrative Procedure Act; and

(2) The Commission has prejudged the merits.

Respondents further move for an order requiring, for the purpose of examination and copying, the production of any and all documents, memoranda, correspondence and all other written communications in this case by or between members of the Commission's staff and the Commission in any way referring or relating to the Commission's "Special Study of Securities Markets" or to the investigation conducted by the staff of said "Special Study."

As further grounds for this motion, which respondents request be argued orally, the undersigned refer the Commission to respondent's brief served and filed herewith.

March 16, 1966

DICKSTEIN, SHAPIRO & GALLIGAN

By David I. Shapiro

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spondents Hodgdon, Haight, Kitain,
Adam, Harper, Davis and Kibler

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
April 18, 1966

RECEIVED
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In the Matter of
HODGDON & CO., INC. (8-8427)
A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

ORDER DENYING MOTIONS TO DISMISS
THE ORDER FOR PROCEEDINGS AND
FOR PRODUCTION OF DOCUMENTS

Respondents Hodgdon & Co., Inc. ("registrant"), A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis, and Robert F. Kibler filed motions to dismiss the order for proceedings issued by the Securities and Exchange Commission ("Commission") on March 2, 1966 on the grounds that:

(1) The Commission's refusal to conduct this proceeding privately and to hear oral argument on that issue constitutes a violation of due process of law and Section 6(a) of the Administrative Procedure Act; and

(2) The Commission has prejudged the merits.

In addition, these respondents also seek production of documents and written communications by or between members of the Commission's staff and the Commission relating to the Commission's "Special Study of Securities Markets".

Respondent Louis S. Amann also moves to dismiss on the grounds set forth in item (2) and for the production of the same documents referred to above. Supporting briefs have been filed on behalf of the moving

parties and opposing briefs by the Division of Trading and Markets ("Division").

The order for proceedings alleges, in substance, that all respondents, "singly and in concert", violated the anti-fraud provisions of the securities laws; that certain of the respondents, "singly and in concert", offered and sold unregistered securities, failed to furnish proper confirmations of transactions to customers and failed to maintain proper books and records; that certain of the respondents, "singly and in concert", while engaged as underwriter, failed to promptly transmit funds to the issuer; and that certain of the respondents, "singly and in concert", failed to promptly amend registrant's broker-dealer application.

Movants urge that the Commission's refusal to hold a private rather than public hearing in this proceeding results in discriminatory enforcement of the Securities Exchange Act, Section 22. Their argument is predicated principally on the differences in treatment by the Commission of the instant proceeding and Shearson, Hamill & Co.^{1/} in which private proceedings were ordered. They assert that the cases are so similar in nature as to afford "no rational basis" for different treatment.

The pertinent portion of Section 22 provides that: "Hearings may be public ***" thus placing full discretion in the Commission to institute public rather than private proceedings.^{2/} It is the Commission's

^{1/} Securities Exchange Act Release No. 7743 (November 12, 1965)

^{2/} J. H. Goddard & Co., Inc., Securities Exchange Act Release No. 7321 (May 22, 1964).

long standing policy that "Private hearings should be the exception rather than the rule."^{3/} To this Hearing Examiner's knowledge the majority if not, indeed, the overwhelming majority of revocation proceedings alleging violation of the anti-fraud provisions of the securities laws have been public proceedings. In the light of the recognized reasons for holding public rather than private proceedings,^{4/} and since there appears to be no question that this policy has been followed, it is manifest that there has been no showing of the "clear abuse" required to overturn the Commission's exercise of discretion in this case.^{5/}

Of course, the Hearing Examiner has no information relating to the Commission's deliberations. But it must be readily apparent that in the appropriate exercise of the discretion granted the Commission by the Congress

^{3/} Utilities Employees Securities Company, et al., 3 S.E.C. 1087, 1094 (1938).

^{4/} Loss, Securities Regulations, Second Edition, Vol. II, p. 1344; J.H. Goddard & Co., Inc., supra, in which those reasons are stated as follows:

"Public proceedings not only apprise investors of possible causes of action against broker-dealers prior to the running of the statute of limitations, but also enable investors to institute such actions promptly before any of their witnesses have become unavailable, and may encourage persons to come forward to testify or to request leave to be heard or to intervene. In addition, public proceedings may alert investors to certain activities of broker-dealers, and inform the industry that the Commission has instituted action with respect to such activities."

^{5/} Carlson v. Landon, 342 U.S. 524, 540-41 (1952).

something more than merely the general anti-fraud nature of the allegations of an order for proceeding may well constitute an important part of the Commission's considerations in determining whether the proceeding should be public or private. For example, only one security was involved in Shearson whereas the order for proceedings in this case alleges that registrant advised its customers as to "securities investments, real estate, taxation, trusts and wills, oil and gas and insurance without suitable training in such field * * *." Further, in this case registrant is a local firm and the alleged violations occurred in its central office, presumably under the eyes of the firm's principals, whereas Shearson involved a much larger firm with many branches throughout the United States and some in foreign countries and the violations occurred in its West Coast branch offices.^{6/} But it is unnecessary either to list the differences between Shearson and the instant matter or to attempt to conjecture as to the bases for the Commission's "public or private" decisions. It is sufficient that the matter has been held to "rest in the sound discretion of the agency created by the Congress and not with the courts * * *."^{7/}

Nor does the Commission's refusal to hear oral argument on the public or private question violate due process. In Federal Communications

6/ See Goddard, note 5, p. 2 as to the dubious effectiveness of the waiver of the statute of limitations offered by movants.

7/ Securities and Exchange Commission v. Harrison, 80 F. Supp 226 (U.S.D.C., D.C., 1948), where the question whether investigations by this Commission are to be conducted by "open or closed hearings" was at issue.

Commission v. WJR,^{8/} the Supreme Court reversed a lower court ruling which "would require oral argument upon every question of law apart from interlocutory matters,"^{9/} arising in administrative proceedings of every sort." Although the court also recognized that oral argument as a matter of procedural due process varies from case to case, no justification for oral argument is apparent here.

Moreover, the Commission's consideration of the letter of August 16, 1965, submitted by those movants urging this issue and which sets forth at length their arguments in favor of private rather than public proceedings, constituted a sufficient hearing under any reasonable requirement of due process in view of the nature of the issue and, certainly, under Section 6(a) of the Administrative Procedure Act, assuming arguendo that section requires any hearing on this question.

The several cases cited by movants relating to discriminatory or arbitrary action as violative of due process of law are inapposite. Neither the question of the propriety of segregation in the schools nor the unconstitutionality of allegedly discriminatory statutes^{10/} is relevant. And in the situation where exercise of discretion by the Secretary of State in the issuance of passports was challenged, the Court held that his discretion was limited historically, and so understood by Congress

^{8/} 337 U.S. 265 (1949).

^{9/} Interlocutory matters are described as "stays pendente lite, temporary injunctions and the like."

^{10/} Schneider v. Rusk, 337 U.S. 163 (1964); Weiman v. Updegraff, 344 U.S. 183 (1952); cf. Rudder v. United States, 226 F. 2d 51 (C.A.D.C., 1955); Taylor v. United States, 320 F. 2d 843 (C.A. 9, 1963).

in enacting the statute under which he acted.^{11/}

Movants' assertion that the Commission has prejudged the merits is predicated upon the Commission's Report of Special Study of Securities Markets, Part I, pp. 261-], transmitted to the Congress on April 3, 1963 "pursuant to Section 19(d) of the Securities Exchange Act of 1934
* * *. "^{12/}

The allegedly offending portion reads:

"Specialization by itself is not only inevitable but in many respects desirable. There is a danger, however, that the specialist may not hold himself out to the public as such, but may project an image of equal willingness to sell, and equal knowledge about, securities other than those within his specialty. In such instances, specialization strains the broker's obligation to deal fairly with his customer, and strains it even further where a relationship of of trust and confidence has been developed.

"An example of this practice appeared in the study's public hearings. The brokerage firm of Hodgdon & Co., Inc., which employs over 50 salesmen in 3 offices, advertises itself extensively, both in newspapers and on the radio, as 'specialists in financial planning,' emphasizing in its advertisements its special ability to devise an investment program tailored to the individual needs of each customer. In fact the firm's salesmen are instructed, in making recommendations to customers who avail themselves of the firm's offer of financial planning, to follow a fairly rigid investment formula under which the customer will divide the major part of his capital between mutual funds and real estate syndications, the latter described by the firm as 'blue chips.' Approximately one-third of the real estate issues purchased by customers were in enterprises promoted by the firm, and one-half of the mutual fund shares sold were of a fund in which the proprietor of the firm had an interest through the fund's management company. Extra compensation is paid on sales of this fund and on real estate syndications promoted by the firm. The emphasis on real estate participations and mutual funds is reflected in the fact that in the firm's 8-year history, less than 20 issues of industrial companies have been recommended to customers and of these, 8 were underwritten by the firm."

11/ Kent v. Dulles, 357 U.S. 116 (1958).

12/ As stated in the Commission's letter of transmittal, that section "directs the Commission to make a broad study of the adequacy of investor protection in the securities markets."

The "rule of necessity" conclusively rebuts this contention. In Marquette Cement Mfg. Co. v. Federal Trade Commission,^{13/} as here, the claim of prejudgment was based upon reports made by the Commission either to the Congress or the President as required by statute. The Court assumed that the Commission from numerous investigations had formed an opinion on the issues involved. It held, nevertheless, citing extensively from other cases, that the "stern rule of necessity" will not permit destruction, through disqualification, "of the only tribunal with power on the premises."^{14/} On appeal the Supreme Court,^{15/} having made the same assumption as did the lower court as to the formation of an opinion on the issues by the Commission, agreed with that court's holding rejecting disqualification of the Commission. The Supreme Court also pointed to a further objectionable aspect of the respondents' position:

"Yet if Marquette is right, the Commission, by making studies and filing reports in obedience to congressional command, completely immunized the practices investigated, even though they are 'unfair;' from any cease and desist order by the Commission or any other governmental agency."

Respondents recognize the "rule of necessity" but argue that it does not apply where a tribunal other than the Commission may take

^{13/} 147 F. 2d 589 (C.A. 7, 1945).

^{14/} See also Federal Home Loan Bank Board v. Long Beach Savings & Loan Association, 295 F. 2d 403 (C.A. 9, 1961).

^{15/} Federal Trade Commission v. Cement Institute, 333 U.S. 683 (1948).

appropriate action. They assert that they are all registered with the National Association of Securities Dealers, Inc. ("NASD") and subject to appropriate disciplinary action by that body. But the sanctions available to the NASD are limited to suspension or withdrawal of registration only from that organization. The Commission, alone, is clothed with the authority and charged with the responsibility, where the public interest would require, of imposing suspension or revocation on a broker and dealer or the barring or suspension of a registered representative,^{16/} thus totally or partially excluding a broker-dealer or registered representative from related activity in the securities business.

Moreover, assuming that the Commission had formed an opinion, "it [does] not necessarily mean that the minds of its members are irrevocably closed on the subject * * *."^{17/} All the rights of respondents to establish their defense by evidence, cross-examination of witnesses, legal argument and other properly available means are preserved including judicial review of the Commission's ultimate decision, if adverse.^{18/} Under those circumstances it is not to be assumed in advance of hearing that the Commission, a responsible Government body, will fail to carry out their manifest duty.^{19/} It is also relevant that the combination of investigative and judicial functions within one agency does not violate due

^{16/} Cf. Marquette Cement Mfg. Co. v. F.T.C., supra, at pp. 593-4.

^{17/} Federal Trade Commission v. Cement Institute, supra, p. 701.

^{18/} Ibid.

^{19/} National Lawyers Guild v. Brownell, 225 F. 2d 552 (C.A.D.C. 1955).

due process.^{20/} Any other conclusion would circumscribe not only the Commission's activity discussed here, i.e., its report pursuant to Congressional directive, but, in addition, its recognized right to consider the staff's investigatory reports in connection with its deliberations as to the advisability of the institution of proceedings.

Neither Texaco Inc. v. Federal Trade Commission^{21/} nor Amos Treat & Co. v. Securities and Exchange Commission^{22/} cited by movants are pertinent here. Texaco involved a statement indicating prejudgment by one commissioner in the course of a speech made during the pendency of the administrative proceeding and Treat turned on the question of one commissioner's participation in an administrative proceeding where formal investigation of the respondent had been conducted by one of the Commission's divisions at the time that commissioner was its director. Indeed, the court specifically distinguished Treat from the "rule of necessity" cases.^{23/}

Such documents and communications as may have passed between members of the Commission's staff and the Commission relating to the special study are not ordinarily subject to discovery.^{24/} Moreover, since

^{20/} Pangburn v. Civil Aeronautics Board, 311 F. 2d, 349 (C.A.1, 1962).

^{21/} 336 F. 2d, 754 (C.A.D.C. 1964).

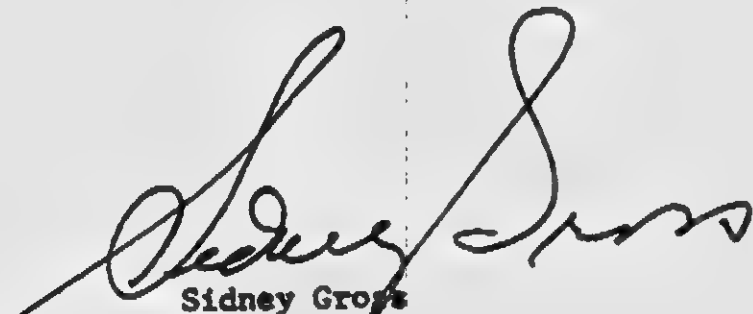
^{22/} 306 F. 2d, 260 (C.A.D.C. 1962).

^{23/} Ibid p. 267 note 12.

^{24/} North American Airlines, Inc. v. Civil Aeronautics Board, 240 F. 2d 867 (C.A.D.C. 1956).

the motion to dismiss for prejudgment of the merits cannot be granted, such documents are neither relevant nor material.^{25/} Accordingly,

IT IS ORDERED that the motion to dismiss the order for proceedings for the Commission's refusal to conduct these proceedings privately and to hear oral argument on the issue; the motions to dismiss on the ground that the Commission has prejudged the merits; and the motions for the production of documents are hereby denied.



Sidney Gross
Hearing Examiner

25/ San Francisco Mining Exchange, supra, pages 4, 5.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC.

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

File No. 3-533

PETITION TO COMMISSION FOR
REVIEW OF RULINGS OF THE HEARING EXAMINER

Pursuant to Rule 12(a) of the Commission's Rules of Practice, respondents Hodgdon & Co., Inc., A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis, and Robert F. Kibler, respectfully request the Commission to review the rulings of the Hearing Examiner denying respondents' motions to dismiss the order for proceedings and for the production of certain documents for inclusion in the record. Said

rulings were made on April 18, 1966, and a petition to the Hearing Examiner to certify said rulings for review by the Commission was denied on May 2, 1966. The reasons in support of this request are set forth in the accompanying Memorandum of Law.

May 6, 1966

DICKSTEIN, SHAPIRO & GALLIGAN

By

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Special Counsel for Said Respondents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
HODGDON & CO., INC.

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

File No. 3-533

MEMORANDUM IN SUPPORT OF
PETITION FOR REVIEW

Respondents have heretofore moved to dismiss this proceeding on the grounds that:

1. They have been denied equal protection of the laws because they were not accorded a private hearing although other persons subject to disciplinary proceedings, some of whom were named in respondents' motion papers, were granted private proceedings; and

2. The Commission has prejudged the proceedings by its Report in connection with its Special Study of Securities Markets undertaken by the Commission pursuant to legislation enacted by the Congress.^{1/}

Annexed hereto as Exhibit A is a copy of respondents' motion to dismiss and brief in support thereof.

The Hearing Examiner denied the motion to dismiss and adjunct motion to produce on April 18, 1966, and on May 2, 1966 denied a petition to certify his rulings to the Commission for review. The primary ground for the Hearing Examiner's denial of certification is doubt as to the probability of reversal of his original rulings. The Examiner also stated that since there would be adequate opportunity to present this petition for review to the Commission prior to June 13, 1966, the date scheduled for commencement of hearings, no "unusual expense" factor would arise from his declining to certify. It is self-evident, however, that there will be "unusual expense" if the Commission requires respondents to undergo a plenary proceeding before it

^{1/} Respondents have also moved for the production of documents which would go to the question of prejudgment (see Exhibit A, p. 8, ftn. 8).

considers the issues raised by the motion to dismiss, for a favorable ruling on respondents' motion to dismiss will dispose of the entire matter and eliminate all the delay and expense of a plenary proceeding. Sweeping charges have been made against the respondents in the proceeding. Their extent and nature suggests a hearing which may last for several years. The delay and expense of an extensive trial is further made certain by the policy of the Commission, as announced to respondents by members of the staff of the Division of Trading and Markets, of refusing to consider offers of settlement unless and until a substantial record is made in the proceedings for examination by the Commission. Whatever may be the merits of the policy, vis-a-vis the Administrative Procedure Act,^{2/} the policy

2/ Section 5(b) of the Administrative Procedure Act provides "that the agencies shall afford all interested parties opportunity for 1. * * * offers of settlement, or proposals of adjustment where time, the nature of the proceeding, and the public interest permit * * * ." The report of the Senate committee which submitted the Administrative Procedure Act (see Administrative Procedure Act legislative history compilation of analysis of the provision of the Act by Congress of the Attorney General at page 34) states:

"The preliminary settlement by consent provision of this subsection is of the greatest importance. Such adjustments may go to the whole or any part of any case. The limitation of the requirement to cases in which 'time, the nature of the proceeding, and the public interest permit' does not mean

makes it clear that an extensive record will have to be compiled before it is even possible to shorten or terminate the proceeding by settlement. In fact respondents have proposed informal settlements but these have been rejected because of the aforestated Commission policy.

It is manifest therefore that a reversal of the Examiner's ruling at the end of the case, after the completion of an entire record in a complex proceeding involving twelve respondents will involve a very substantial expense in counsel fees and absorb a substantial part of the time of the officers of respondent Hodgdon & Co., thus severely and adversely affecting the conduct of its business. Under such circumstances, Rule 12(a) would appear

(2) (Continued) that formal proceedings, to the exclusion of prior opportunity for informal settlement, lie in the discretion of any agency irrespective of the facts, legal situation presented or practical aspects of the case. It does not mean that agencies have an arbitrary choice, or that they may consult their mere preference or convenience. It is intended to exempt only situations in which, for example, (1) time is unavoidably lacking, (2) the nature of the proceeding is such that for example (as in some forms of rule making) the great number of parties or possible parties makes it unlikely that any adjustment could be reached, and (3) the administrative function requires immediate execution in order to protect the tangible and demonstrable requirements of public interest." (Emphasis supplied.)

to be expressly applicable since a favorable ruling on the motion made by the respondents would terminate the case and avoid all of such expense.

In respect of the Examiner's ruling that the denial of a private proceeding to the respondents was not a denial of due process and the equal protection of the laws, we respectfully suggest that although the Securities Exchange Act provides as stated in the Hearing Examiner's memorandum, that hearings may be public, the Commission's Rule 11(b) provides that with certain exceptions hearings "shall be public unless otherwise ordered by the Commission." The Commission's publications are full of reasons why hearings should be public. On the other hand, there seems to be no clearly enunciated criteria as to when hearings shall be private, other than in the absolute discretion of the Commission. The Examiner himself concedes, on the basis of his own experience, that at least a minority of disciplinary proceedings alleging violation of anti-fraud provisions of the securities laws have been private. We have adverted to several of such proceedings in our memorandum accompanying our motion for dismissal of the proceedings.

The Hearing Examiner himself states that he has no

information relating to the reasons of the Commission for denying the respondents' application for a private hearing. There has been no written reply by the Commission in this proceeding setting forth the basis of its decision to make the proceeding public notwithstanding an explicit request by the respondents for a private proceeding set forth in a letter to the Commission dated August 16, 1965. The Hearing Examiner nevertheless equates the Commission's order for a public proceeding as constituting a sufficient "hearing" on our request for a private proceeding. But the mere institution of a public proceeding is not a "hearing" in response to our request for a private proceeding. Indeed, the Hearing Examiner himself has been required to conjecture as to the Commission's reasons for denying a private hearing. He attempts to distinguish the matter from Shearson by referring to the fact that more than one security is involved and that the respondent is a small firm, whereas Shearson was a very large firm, but such grounds for granting private hearings in lieu of public hearings have never been advanced publicly by the Commission.

Respondents have requested a statement for the record by the Commission of the number of private proceedings held

within the last year and the nature of the charges involved in such proceedings so that the courts may, if necessary, determine for themselves whether or not there is any ascertainable basis for the decisions made by the Commission or whether such decisions are based on reasons which are presently unarticulated in any of the Commission's decisions. For example, the Commission has stated that public hearings are usually held where the facts are already public. The facts were already public in the instant case, as well as in the Shearson case, but in the Shearson case and other cases a private hearing was granted. The Commission's decisions have referred to the fact that public hearings are necessary to inform investors of the possibility of causes of action against respondents in disciplinary proceedings and to prevent the possible running of the statute of limitations.^{3/} Yet, it appears that

^{3/} The Hearing Examiner's opinion refers to the "dubious effectiveness of the waiver of the statute of limitations" offered by the respondents. We appreciate that there are some indications in the judicial decisions that the period for bringing actions under Section 12(1) and 12(2) of the Securities Act are an inherent facet of the cause of action. Nevertheless, we believe that it is improbable a court will dismiss complaints brought under these sections where defendants are estopped from asserting this defense. The respondents' offer to waive this statute of limitations is therefore meaningful and would protect investors, particularly for causes of action at common law, and under Section 17 of the Securities Act and Section 10(b) of the Securities Exchange Act.

private hearings have been granted where such factors were also present, such as the Shearson case, and the other cases cited in our memorandum accompanying our motion to dismiss. We submit that there is no clearly ascertainable basis which would enable counsel in a matter to determine whether or not respondents will receive a private hearing. Indeed, if review here served no purpose other than to articulate the standards, that would be purpose enough.

We turn now to the prejudgment issue. The Hearing Examiner in denying our motion to dismiss the proceeding on the ground that the Commission's report of its Special Study has prejudged the matter relies almost exclusively on Federal Trade Commission v. Cement Institute, 333 U.S. 683 (1948). But in that case the reports made by the Federal Trade Commission to the Congress which were the basis for the alleged prejudgment did not deal with specific companies or charge them after public hearing with the perpetration of specific illegal practices. Here, on the other hand, the Commission in its Special Study specifically singled out respondent, Hodgdon & Co., examined its officers under oath, inquired into its selling practices and other matters, and published what amounted to findings of fact and conclusions of law against the respondent. In lieu of

condemnation by Special Study, the Commission clearly had the power to institute administrative or judicial proceedings against respondents for alleged illegal practices. We think such circumstances bar application of the so-called "rule of necessity." And when there exists an agency, the National Association of Securities Dealers, which has coordinate power to deal with the matters charged against the respondents, the "rule of necessity" does not come into play at all. The Examiner makes the distinction that the Commission's powers are broader than the NASD's. This may be so in a narrow legal sense, but there is no practical distinction between suspension or expulsion from membership in the NASD and suspension or revocation of a broker-dealer registration. Either would just as effectively bar respondent from doing business. In any event, the policy of the law to impose a most rigorous appearance of fairness on the part of administrative agencies should outweigh the narrow distinction between the powers of the two agencies.

Respondents have also moved for the production of certain documents which would disclose the relationship of the Study Report to the instant proceeding. The Hearing Examiner's ruling denies access to these records. We believe such records must be supplied to enable respondents

in the first instance, and the Commission and courts thereafter, to appraise the nature and extent of involvement in prejudgment. But this much is clear. The Examiner has denied the application for production as well as the motion to dismiss for prejudgment with no idea whatever of what, if anything, these documents would show. The rulings of the Hearing Examiner are therefore as to matters which are peculiarly within the special province and cognizance of the Commission for only the members of the Commission can know: (1) the basis upon which they exercised their discretion to order a public proceeding in this case, (2) the extent to which they participated in the prejudgment explicit in the Special Study, and (3) what, if anything, Commission documents would reveal concerning the relationship between the Special Study and this proceeding. As the Examiner has observed, these are matters on which persons other than the members of the Commission can only speculate.

This petition, of course, presents only the question of whether interlocutory review is appropriate. A decision on the merits of respondents' motion to dismiss and adjunct motion to produce can only be made after full briefing and

argument. Thus, the only question now to be decided is whether the Commission should itself consider these motions. Since they go to important questions of policy, vitally effect the interests of the respondents, and a ruling favorable to respondents could well terminate this entire proceeding, the Examiner's rulings are particularly appropriate for interlocutory review.

Accordingly, respondents respectfully request that this petition for review of the rulings made by the Examiner on April 18, 1966 be granted.

May 6, 1966

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
May 23, 1966

Memorandum to: Office of Records and Service
Copies to: Parties to the Proceedings

Re: Hodgden & Co., Inc., et al.
(File 3-5427)

In the matter of the public proceedings under Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 pending in respect of Hodgden & Co., Inc., et al. (File 3-5427), the Commission considered a petition by registrant and A. Dana Hodgden, James F. Knight, Burton Kitain, W. Lyles Carr, Jr., David M. Adams, Jr., James W. Harper, III, Robert E. Davis and Robert W. Kibler ("Hodgden group"), and a petition by Louis S. Amann, filed pursuant to Rule 12(a) of the Commission's Rules of Practice, for review of rulings by the hearing examiner, which the latter refused to certify to the Commission, denying motions made by petitioners. One motion by the Hodgden group asked for dismissal of the order for proceedings. It asserted that the Commission's denial of petitioners' request to make these proceedings private deprived petitioners of equal protection of the laws because similar disciplinary proceedings had been accorded private treatment and was arbitrary because it was entered without a hearing or the setting out of any reasons. The motion further asserted that the Commission had prejudged the merits as evidenced by the discussion of certain of registrant's activities in the Commission's Special Study of Securities Markets (H. Doc. No. 95, Pt. 1, 98th Cong., 1st Sess., 261-62 (1953)). The Hodgden group's other motion sought the production of all documents and written communications by or between the Commission's staff and the Commission relating to the Special Study or to the investigation conducted by the staff of the Special Study. Amann's motions also asked for dismissal of the order for proceedings, on the ground of prejudgment, and for production of the same records. The Division of Trading and Markets of the Commission filed a memorandum opposing the petitions.

Petitioners urged that the hearing examiner's rulings involved important questions of policy, and that a ruling favorable to them at this time would terminate the entire proceeding and avoid the burdensome expense and the adverse effect on registrant's business

that would be involved in an extended defense against the charges. Petitioners further argue that extensive hearings were made more certain by an alleged Commission policy, of which they were allegedly informed by the staff in rejecting offers of settlement by various respondents, of refusing to consider settlement offers unless and until a substantial record was made.

With respect to the prejudgment issue, petitioners stated that the Special Study specifically inquired into registrant's selling practices and other matters and published what they contained amounted to findings of fact and conclusions of law against registrants. The production of documents in connection with the Special Study was sought by petitioners for the stated purpose of enabling them and thereafter the Commission and courts to appraise the nature and extent of the Commission's involvement in the asserted prejudgment.

The Commission, after consideration of the petitions, the hearing examiner's detailed opinion respecting the motions, and his orders on petitions made to him to certify his rulings, was of the view that he correctly refused to certify his rulings denying the motions.

The Commission noted that the contentions presented by petitioners with respect to the institution of public rather than private proceedings were to some extent similar to those it had rejected in *J. H. Gaffney & Co., Inc., Securities Exchange Act Release No. 7725* (May 22, 1965). It also noted that the Division denied that the Commission's policy had been stated to be against offers of settlement absent a substantial record, and it pointed out that in any event such was not the Commission's policy and under Rule 8 of its Rules of Practice such offers might be made "at any time" during the course of the proceedings and in advance of the hearings and an offer rejected by the Division would be presented to the Commission upon request of the party making the offer. See *Harmon Wilson & Co., Inc., Securities Exchange Act Release No. 7725*, p. 6 (October 12, 1965).

In connection with petitioners' prejudgment argument, the Commission stated that the discussion in the Special Study related to only one possible aspect of the misconduct alleged in the Commission's order for proceedings, namely, a practice of registrant, which allegedly specialized in and generally confined its recommendations to certain types of securities, of projecting an image of equal willingness to sell, and equal knowledge about, securities other than those within its specialty. In addition, the Commission's order raised issues, among other things, with respect to alleged high pressure selling

efforts, the employment of salesmen with little or no experience, training or qualifications, the offer and sale of unregistered securities, the failure to confirm transactions, bookkeeping violations, and fraudulent representations. The Commission further observed that not only was the Special Study prepared in obedience to congressional command as pointed out by the hearing examiner, but, as noted in the letter of transmittal to Congress (Special Study, Pt. I, p. IV), although the Commission "worked very closely with the study" and reviewed the report, "the judgments, analyses, and recommendations in the report are those of the Special Study and not the Commission." Moreover, the Commission emphasized that the record made in these proceedings would, as a matter of legal requirement, constitute the sole basis for its decision irrespective of any of the findings in the Special Study. See Fangburn v. C.A.E., 311 F. 2d 349 (C.A. 1, 1962).

The Commission accordingly denied the petitions for review of the hearing examiner's rulings.

Orval L. DuBois

Orval L. DuBois
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC.

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

File No. 3-533

ANSWER

Dickstein, Shapiro & Galligan and Harry Heller, appearing for Hodgdon & Co., Inc., A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis and Robert F. Kibler, and answering the allegations contained in the order for proceedings on their behalf, state as follows:

1. Admit the allegations of IIA.
2. Deny the general allegations of IIB and further

deny knowledge or information with regard to any specific allegations which may be included within said general allegations and request a more definite statement as set forth in the accompanying motion therefor as an aid to further pleading.

3. Deny the general allegations of IIC and further deny knowledge or information with regard to any specific allegations which may be included within said general allegations and request a more definite statement as set forth in the accompanying motion therefor as an aid to further pleading.

4. Deny the general allegations of IID and further deny knowledge or information with regard to any specific allegations which may be included within said general allegations and request a more definite statement as set forth in the accompanying motion therefor as an aid to further pleading.

5. Deny the general allegations of IIE and further deny knowledge or information with regard to any specific allegations which may be included within said general allegations and request a more definite statement as set forth

in the accompanying motion therefor as an aid to further pleading.

6. Deny the general allegations of IIF and further deny knowledge or information with regard to any specific allegations which may be included within said general allegations and request a more definite statement as set forth in the accompanying motion therefor as an aid to further pleading.

March 17, 1966

DICKSTEIN, SHAPIRO & GALLIGAN

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Adam, Harper, Davis and Kibler

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
HODGDON & CO., INC.

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

File No. 3-533

MOTION FOR A MORE DEFINITE STATEMENT

Come now Dickstein, Shapiro & Galligan and Harry Heller, attorneys for Hodgdon & Co., Inc., A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis and Robert F. Kibler, and move pursuant to Rule 7(d) for a more definite statement with regard to the matters alleged in the order for public proceedings.

The order contains a host of general allegations: for example, that one or more of the eleven named individual

respondents, at sometime during a period of fifty months made, or permitted others who are not named to make, unspecified untrue or misleading statements about unidentified securities; that one or more of the eleven at sometime during a period of fifty months induced, or permitted others who are not named to induce, unnamed customers to sell unidentified "seasoned" investments and purchase unidentified "speculative" ones; that one or more of the eleven at sometime during a period of fifty months sold, or permitted others who are not named to sell, unidentified securities to unnamed customers without diligent inquiry as to the true nature and worth of those securities; and so forth.

No respondent can intelligently answer such allegations (see Answer paragraphs 2-6), nor as a matter of law are such allegations sufficient to give notice of the charges against which a respondent may be required to defend. The allegations are even insufficient to determine whether there might be a conflict of interest as amongst the various respondents requiring retention of separate counsel from the inception of the proceeding.

Charges as broad and unspecific as those made here violate the "due process" clause of the Fifth Amendment to

the United States Constitution, Section 15 of the Securities Exchange Act of 1934, and fail to set forth "the factual and legal basis alleged therefor in such detail as will permit a specific response thereto" as required by Rule 6(a) of the Commission's Rules of Practice.

Accordingly, the aforementioned respondents move for a more definite statement which will state with particularity the following:

With regard to ¶II.B(1):

(a) The names of the salesmen referred to therein, the approximate date or dates of their employment, the basis on which it is alleged that a named respondent permitted or arranged for the employment of such salesmen, the alleged deficiencies in the training of such salesmen, and the basis upon which each respondent is deemed to be responsible for the alleged inadequacy or unsuitability of such training.

(b) The names of the customers whom such salesmen advised on matters of securities investments, real estate, taxation, trust and wills, oil and gas and/or insurance and the nature of the advice given.

(c) The manner in which such alleged advice is deemed to be erroneous, and the basis upon which each respondent is deemed to be responsible for the giving of such advice and/or is deemed to be responsible for the alleged inadequacy or unsuitability of training in each of the areas in which erroneous advice was allegedly given.

(d) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(2):

(a) The names of the inexperienced and unsophisticated customers who allegedly reposed complete trust and confidence in each respondent.

(b) The basis upon which it is alleged that each such customer lacked experience and sophistication.

(c) The manner, means and time when each

respondent induced each such customer to repose complete trust and confidence in him.

(d) If it is alleged that a respondent was responsible for any act or statement made by some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(e) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(3):

(a) Whether the customers referred to in this subparagraph are the same customers as those referred to in subparagraph II.B(1) and/or II.B(2), and if not, state the names of the customers to whom this allegation refers.

(b) The manner, means and time when each respondent caused each such customer to believe that he had

special skill, knowledge, and experience in financial planning, including securities investments.

(c) The basis upon which it is alleged that such representations of special skill, knowledge and experience were false or fraudulent.

(d) If it is alleged that a respondent was responsible for any act or statement made by some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(e) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(4):

(a) Whether the customers referred to in this subparagraph are the same customers as those referred to in subparagraph II.B(1) and/or II.B(2) and/or II.B(3), and if

not, state the names of the customers to which this allegation refers.

(b) The manner, means and time when each respondent induced each such customer to sell seasoned securities out of his investment portfolio and reinvest the proceeds in unseasoned and speculative securities in which respondents had direct and indirect interests.

(c) Identify the seasoned securities which each such customer was induced to sell.

(d) Identify the unseasoned and speculative securities which each such customer was induced to purchase and the basis upon which it is alleged that respondents, or any of them, had direct and/or indirect interests in such securities.

(e) If it is alleged that a respondent was responsible for any act or statement made by some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(f) If it is alleged that respondents or any of them acted in concert with regard to the matters set

forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(5):

(a) Whether the customers referred to in this subparagraph are the same customers as those referred to in subparagraph II.B(1) and/or II.B(2) and/or II.B(3) and/or II.B(4), and if not, state the names of the customers to which this allegation refers.

(b) The occasion on which it is alleged that each respondent failed to disclose to a customer his special interest in a transaction with regard to commissions, charges and profits on said transaction.

(c) In each instance in which it is alleged that a respondent failed to disclose to a customer his special interest in a transaction state the basis upon which it is alleged that there was an obligation to make such disclosure and the manner in which such disclosure should have been made.

(d) If it is alleged that a respondent was responsible for such failure to disclose by some other respondent, state the basis upon which each such respondent is alleged to be responsible for such failure to disclose by another respondent.

(e) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(6):

(a) Whether the customers referred to in this subparagraph are the same customers as those referred to in subparagraph II.B(1) and/or II.B(2) and/or II.B(3) and/or II.B(4) and/or II.B(5), and if not, state the names of the customers to which this allegation refers.

(b) The manner, means and time when each respondent caused each such customer to retain trust and confidence in him by means of lulling letters and/or oral

representations that they were better off because of the financial advice given by such respondent when, in fact, said customer had suffered a loss or was no better off than he was before dealing with such respondent.

(c) The basis upon which it is alleged that such oral or written statements were false or fraudulent.

(d) If it is alleged that a respondent was responsible for any act or statement made by some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(e) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to §II.B(7):

(a) Identify the alleged speculative and unseasoned securities distributed and sold by the respondents

or any of them.

(b) The basis upon which it is alleged that a respondent or respondents were on notice of facts and circumstances making an inquiry into the nature and worth of such securities essential.

(c) The manner, means and time when each respondent was given or received notice of such facts and circumstances.

(d) The basis upon which it is alleged that each respondent failed to make reasonable and diligent inquiry as to the true nature and worth of such securities.

(e) The information pertaining to such securities which it is alleged a reasonable and diligent inquiry would have revealed concerning the background of the issuers, the circumstances surrounding their organization, the history as to their operations, earnings, dividends, current financial condition and similar matters.

(f) The basis upon which it is alleged that a respondent or respondents were legally under an obligation to make such inquiry or inquiries.

(g) Whether it is alleged that the distribution and each sale of each such security was required to be made pursuant to a registration statement under the Securities Act, and if so, whether such registration statement or statements were filed and whether a copy of the prospectus was delivered to a purchaser thereof in connection with the distribution and each sale of each such security.

(h) If it is alleged that a respondent was responsible for any act or statement made by some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(i) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(8):

(a) Whether the customers referred to in this subparagraph are the same customers as those referred to in subparagraph II.B(1) and/or II.B(2) and/or II.B(3) and/or II.B(4) and/or II.B(5) and/or II.B(6) and/or II.B(7), and if not, state the names of the customers to which this allegation refers.

(b) Whether the securities referred to in this subparagraph are the same as the securities referred to in subparagraph II.B(7).

(c) The manner, means and time when each respondent engaged in the distribution and sale of such securities without disclosing his failures to make the inquiries described in subparagraph II.B(7) and to obtain and disclose the material adverse information which reasonable and diligent inquiry would have revealed concerning each such security.

(d) If it is alleged that a respondent was responsible for any act or omission of some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or omission of another respondent.

(e) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(9):

(a) Whether the customers referred to in this subparagraph are the same customers as those referred to in subparagraph II.B(1) and/or II.B(2) and/or II.B(3) and/or II.B(4) and/or II.B(5) and/or II.B(6) and/or II.B(7) and/or II.B(8), and if not, state the names of the customers to which this allegation refers.

(b) The manner, means and time when each respondent endeavored by the use of high pressure selling efforts to place each such customer in a position where he was asked to make hasty decisions to buy securities upon the basis of incomplete, untrue, deceptive and unsubstantiated representations..

(c) If it is alleged that a respondent was

responsible for any act or statement made by some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(d) If it is alleged the respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to §II.B(10):

(a) Which respondent or respondents offered to sell the securities of U. S. Infrared Corp., when and to whom such offer was made, and the manner and means of each such offer.

(b) To whom each respondent sold and delivered after sale the securities of U. S. Infrared Corp.

(c) The basis upon which it is alleged that the offer and sale of securities of U. S. Infrared Corp. was

required to have been made pursuant to a registration statement under the Securities Act.

(d) Which respondent or respondents offered to sell the securities of Paragon Electrical Manufacturing Corp., when and to whom such offer was made, and the manner and means of each such offer.

(e) To whom each respondent sold and delivered after sale the securities of Paragon Electrical Manufacturing Corp.

(f) The basis upon which it is alleged that the offer and sale of securities of Paragon Electrical Manufacturing Corp. was required to have been made pursuant to a registration statement under the Securities Act.

(g) Which respondent or respondents offered to sell the securities of Data Processing Corp., when and to whom such offer was made, and the manner and means of each such offer.

(h) To whom each respondent sold and delivered after sale the securities of Data Processing Corp.

(i) The basis upon which it is alleged that

the offer and sale of securities of Data Processing Corp. was required to have been made pursuant to a registration statement under the Securities Act.

(j) If it is alleged that a respondent was responsible for any act or statement made by some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(k) If it is alleged the respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(11):

(a) The name or names of the customers to whom a respondent failed to send confirmation of a transaction, the name of the security involved in each such instance, and the name of the respondent or respondents who failed to send such confirmations, and the time when it is alleged that such

respondent or respondents should have sent confirmations of each such transaction to said customers.

(b) If it is alleged that a respondent was responsible for any act or omission of some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or statement of another respondent.

(c) If it is alleged the respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(12):

(a) The names of the salesmen referred to therein.

(b) The alleged deficiencies in the training of such salesmen and the basis upon which each respondent is deemed to be responsible for said deficiencies.

(c) The name of the respondent or respondents who allegedly failed to reasonably supervise a salesman subject to his supervision.

(d) If it is alleged that a respondent was responsible for any act or omission of some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or omission of another respondent.

(e) If it is alleged the respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(13):

(a) The entries on the books and records of registrant which a respondent or respondents failed to make.

(b) The activities which it is alleged were concealed by the failure to make said entries.

(c) The respondent or respondents who are alleged to be responsible for the failure to make said entries and the basis upon which it is alleged that such respondent's or respondents' failure was for the purpose of concealment of certain activities.

(d) If it is alleged that a respondent was responsible for any act or omission of some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act or omission of another respondent.

(e) If it is alleged the respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.B(14):

(a) Concerning each transaction referred to in this allegation state:

1. The name of the customer involved;
2. The name of the respondent making the untrue, deceptive and misleading statement of material facts or omitting to state a material fact;
3. The name of the security so offered or sold;
4. The time and nature of each such statement or omission pertaining to such security.

(b) If it is alleged that a respondent was responsible for any act, statement or omission of some other respondent, state the basis upon which each such respondent is alleged to be responsible for the act, statement or omission of another respondent.

(c) If it is alleged that respondents or any of them acted in concert with regard to the matters set forth in this allegation, state which respondents acted in concert, the date or dates and the manner in which each agreed to join with the others or aided or acquiesced in

said agreement so as to be bound thereby, and the substance of said agreement for concerted action.

With regard to ¶II.D:

(a) When it is alleged that said funds should have been transmitted to the issuer and the amount of funds which should have been transmitted on or before such date.

(b) The manner and means by which it is alleged that respondents Hodgdon, Haight and Carr participated in such alleged violation.

(c) The basis upon which it is alleged that respondents Hodgdon, Haight and Carr were in wilful violation. If the allegation of wilful violation as to one or more of said respondents is based upon his or their instruction to another not to promptly transmit such funds to the issuer, state which of said respondents gave such instruction or instructions, to whom such instructions were given, and the manner or means by which such instructions were transmitted. If the allegation of wilful violation is based upon notice of and acquiescence therein, state which respondent or respondents received such notice, when and how such notice was given, and when and how a respondent or respondents

acquiesced in the failure to transmit such funds.

With regard to §II.E:

(a) The changes in registrant's officers, directors, and holders of 10% or more of its stock which respondents fail to disclose by prompt amendment of registrant's application as a broker-dealer.

(b) The date or dates by which it is alleged such amendments should have been filed.

(c) The basis upon which it is alleged that each respondent named therein is responsible for the failure to make such amendments of registrant's application as a broker-dealer.

(d) The basis upon which, it is alleged that each respondent named therein wilfully failed to make such amendment of registrant's application as a broker-dealer. If the allegation of wilful violation as to one or more of said respondents is based upon his or their instruction to another not to promptly make such amendment of registrant's application as a broker-dealer, state which of said respondents gave such instruction or instructions, to whom such

instructions were given, and the manner or means by which such instructions were transmitted. If the allegation of wilful violation is based upon notice of and acquiescence therein, state which respondent or respondents received such notice, when and how such notice was given, and when and how a respondent or respondents acquiesced in the failure to promptly make such amendment of registrant's application as a broker-dealer.

Respondents request oral argument of the above motion and further request that they be granted fifteen days from the date of a service of a more definite statement within which to file answer thereto.

March 17, 1966

DICKSTEIN, SHAPIRO & GALLIGAN

By *Sidney Dickstein*
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Attorneys for Respondent Hodgdon
& Co., Inc. and individual Re-
spondents Hodgdon, Haight, Kitain,
Adam, Harper, Davis and Kibler

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
April 25, 1966

<hr/>		:
In the Matter of		:
<hr/>		:
HODGDON & CO., INC.	(8-8427)	:
<hr/>		:
A. DANA HODGDON		:
JAMES F. HAIGHT		:
BURTON KITAIN		:
W. LYLES CARR, JR.		:
DAVID M. ADAM, JR.		:
JAMES W. HARPER, III		:
HOMER E. DAVIS		:
ROBERT F. KIBLER		:
LOUIS S. AMANN		:
JAMES L. ROPER		:
HARVEY E. BASKIN		:
<hr/>		:

ORDER GRANTING MOTIONS
FOR A MORE DEFINITE
STATEMENT

Respondents Hodgdon & Co., Inc. ("registrant"), A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis, and Robert F. Kibler have filed a motion for a more definite statement. In a separate motion respondent Louis S. Amann seeks virtually identical relief. The Division of Trading and Markets ("Division") opposes both motions.

The order for proceedings alleges, in general, that all respondents "singly and in concert" violated the anti-fraud provisions of the securities laws in that they permitted registrant's inexperienced salesmen to advise customers regarding their finances including securities investments, real estate, taxation, trusts and wills and other fields; caused inexperienced customers to believe respondents had special skills and experience in financial planning and induced the customers to repose complete

trust and confidence in them; induced customers to purchase speculative securities in which respondents had direct and indirect interests without disclosing such interests; engaged in distribution of speculative, unseasoned securities without diligent inquiry as to their nature and despite notice of facts which should have caused such inquiry and failed to advise customers of their failure to make the inquiry and of adverse facts the inquiry would have disclosed; offered to sell, sold and delivered unregistered securities; failed to send confirmations to customers; failed to adequately supervise salesmen; failed to make entries in registrant's books for the purpose of concealing certain of registrant's activities; made misrepresentations and omissions of material facts in the offer and sale of securities. The order also alleges that certain of the respondents, "singly and in concert" violated Sections 5(a) and 5(c) of the Securities Act of 1933; failed to furnish customers written notification as to the capacity in which registrant acted; and failed to maintain and keep current its books and records. It alleges, further, that certain respondents, "singly and in concert," while acting as underwriter, failed to promptly transmit to an issuer the proceeds of a distribution. It alleges, in addition, that certain respondents, "singly and in concert," failed to promptly amend registrant's broker-dealer application.

The Commission has ruled on numerous occasions that appropriate notice of the proceedings is furnished when a respondent is sufficiently informed of the nature of the charges against him so that he may adequately prepare his defense and that he is not entitled to the disclosure of evidence.^{1/} The order for proceedings specifies the nature of the violations charged, the subject matter of the alleged fraudulent representations and omissions, the general categories of the persons involved and the nature of the acts and transactions alleged as constituting fraud. Such information sought as the names of customers, the exact nature and factual details of each allegedly fraudulent act or omission or series of acts or omissions which together are alleged to constitute fraud, the nature of alleged deficiencies in salesmen's training, the nature of allegedly erroneous advice given to customers and, in general, the facts upon which Division will rely are evidentiary matters which need not be specified prior to the hearing.^{2/}

Movants also seek information as to which respondents acted in concert in respect of the various allegations of fraud charged in paragraph 11 of the order together with the substance of the agreement for concerted action and the basis of each respondent's responsibility for the act of another respondent. It is readily apparent that all respondents are alleged to have participated in a fraudulent common scheme

1/ Keith Richard Securities Corp., 39 S.E.C. 240 (1958); Murray Securities Corporation, 37 S.E.C. 780 (1957); Charles M. Weber, 35 S.E.C. 79 (1953); Mid America Securities, Inc. (File 8-5753), Commission's memorandum dated August 2, 1963.

2/ Ibid. See also Commonwealth Securities Corporation (File 8-6739), Commission's memorandum dated June 10, 1963; Lile & Co., Inc. (File 8-8196), Commission's memorandum dated October 23, 1963.

during the period set forth in the order which also specifies the nature of the activities complained of and alleges that all respondents are charged with responsibility therefor. The substance of the agreement and the basis of respondents' responsibility may be either evidentiary matters or matters of law to which respondents are not entitled in advance of the hearing.

However, discretion may be exercised where something less than the strictest observance of the principles set forth above would serve to expedite the proceedings^{3/} without undue prejudice to the Division, by obviating, largely, the need for the granting of continuances which result in a trial by hearings at intervals. Included among the information sought by movants are the names of securities allegedly sold, the names of salesmen referred to in the order and matters relating to the alleged failure to make certain entries in registrant's books. Although the allegations in respect of which this information is sought assert violations of the anti-fraud provisions of the securities laws, records of salesmen's prior experience together with general books and records reflecting registrant's transactions are required to be made and kept pursuant to Rule 17a-3 promulgated under the Exchange Act of 1934. These items would appear to be in the same general category as requests for a list of the books and records allegedly not in compliance with the Commission's record-keeping requirements, a statement of the manner in which a financial report allegedly was inaccurate, a specification of records which respondent allegedly had failed to preserve, the names of accounts allegedly involved in Regulation T violations, all of which

3/ Murray Securities Corporation, supra.

have been granted by the Commission.^{4/} However, since the purpose of these motions is to afford movants a reasonably adequate opportunity to prepare their defense, material obviously within their knowledge need not be furnished. Accordingly, the Division is directed to furnish the following information:

- (a) The names of the salesmen referred to in Section IIB(1) of the order for proceedings;
- (b) The names of the securities which customers were induced to purchase as set forth in IIB(4);
- (c) The names of the securities referred to in IIB(7);
- (d) If the "distribution" alleged in IIB(7) and IIB(8) was pursuant to one or more registration statements, identify them;
- (e) The names of the customers and "other securities" involved in the transactions referred to in IIB(11);
- (f) The nature of entries not made on registrant's books and records as alleged in IIB(13);
- (g) Which of the misstatements or omissions set forth in IIB(14) was allegedly made in respect of each of the securities named in that paragraph.

^{4/} Commission's Memorandum, Lile & Co., Inc., supra; Mid-America Securities, Inc., supra; Life Shares Trading Corporation (File No. 8-10734), Commission's Memorandum of August 7, 1963; Sutro Bros. & Co., (File No. 8-776), Commission's Memorandum of April 16, 1962.

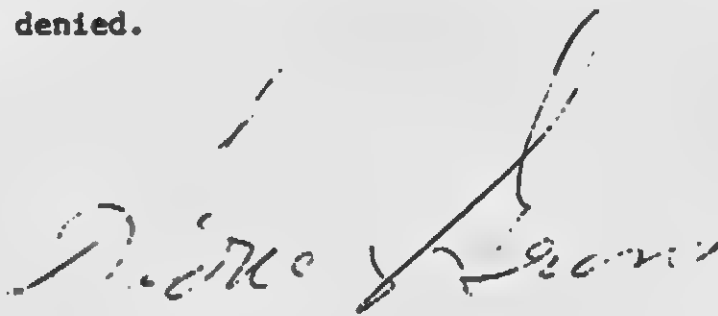
The allegation that the respondents committed violations "singly and in concert" constitutes, in effect, two separate causes of action against which the respondents are required to defend. As to the cause of action which asserts such violations "singly," movants are entitled to be advised and the Division is directed to advise which respondents it asserts committed each of the various violations alleged in the order.

Accordingly,

IT IS ORDERED that the aforesaid motions for a more definite statement are hereby granted to the extent indicated above and in all other respects are denied, and

IT IS FURTHER ORDERED that the Division shall furnish movants with a more definite statement as directed above on or before May 10, 1966, and that movants shall file their answers thereto within ten days after service of the more definite statement upon them.

Respondents' requests for oral argument of their motions for a more definite statement are denied.

A handwritten signature in dark ink, appearing to read "Sidney Gross", is written over the typed name and title.

Sidney Gross
Hearing Examiner

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
HODGDON & CO., INC., et al.
(8-8427)

MORE DEFINITE STATEMENT

The Hearing Examiner's order of April 25, 1966 grants in part certain respondents' Motions for a More Definite Statement concerning matters alleged in the order for public proceedings pursuant to Sections 15(b), 15A and 19(a) of the Securities Exchange Act of 1934. In compliance with the Hearing Examiner's order, the Division furnishes the following information:

(a) The Division, for want of knowledge to supply the names of all such salesmen, and without limiting itself to the possibility that other such salesmen exist, states that the names of the individuals who had little or no prior experience and were employed as salesmen for registrant without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business as alleged in Section II B(1) were:

1. James L. Roper
- 2.. Samuel W. Freed
3. Leslie E. Richardson

4. Thomas L. Piper III
5. Homer E. Davis
6. Robert F. Kibler
7. William Flynn
8. Larry O'Shea
9. Fray C. Johns
10. John F. Saffer
11. Harvey E. Baskin

The names of individuals who advised customers regarding their finances including securities investments, real estate, taxation, trusts and wills, oil and gas, and insurance without suitable training in such fields and without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business as alleged in Section II B(1) were:

1. Samuel W. Freed
2. Leslie E. Richardson
3. James W. Harper
4. Lyles W. Carr
5. Robert F. Kibler
6. Homer E. Davis
7. James F. Haight

(b) The names of the securities which the respondents induced their customers to purchase, as alleged in Section II

B (4), included the securities of the following organizations:

1. Primex Equities Corporation
2. U. S. Infrared Corporation
3. Data Processing Corporation
4. Paragon Electrical Manufacturing Corporation
5. Van Pak, Inc.
6. Capitol Properties, Inc.
7. Toledo Plaza Limited Partnership
8. Rock Creek Limited Partnership
9. Cheverly Terrace Limited Partnership
10. Canandaigus Enterprises Corporation
11. The Connection Company
12. Mid American Life Insurance Company
13. Watson Electronics & Engineering Co., Inc.
14. Metropolitan Security, Inc.
15. Richmond Motor Lodge Limited Partnership
16. Falls Plaza Limited Partnership
17. Mount Vernon Apartments Limited Partnership
18. Big Fish Little Fish Limited Partnership
19. Lord of the Flies Limited Partnership
20. Jonkers Business Machines, Inc.
21. Westfalls Shopping Center Limited Partnership
22. Kent Washington, Inc.
23. Orbit Industries, Inc.

24. Alex Forst & Sons, Inc.
25. Glenn Rose Limited Partnership
26. Apache Canadian Oil & Gas Program 1961
27. Roseville Detroit Limited Partnership
28. Wise Homes, Inc.

(c) The names of the securities which the respondents offered and sold without inquiring into their background, as alleged in Section II B(7), included the securities of the following corporations:

1. Paragon Electrical Manufacturing Corporation
2. Data Processing Corporation

(d) The distributions alleged in Sections II B(7) and II B (8) were not pursuant to registration statements.

(e) Without limiting itself to the possibility that other customers failed to receive confirmations for certain securities transactions, the Division states that the respondents failed to send confirmations to the following customers, as alleged in Section II B(11), regarding the securities enumerated:

U. S. Infrared Corporation

1. A. David Drosnes
2. Arthur H. Rosen
3. Fred Clarke

Data Processing Corporation

4. Steve V. Boggs
5. Wilbur B. Cretsinger
6. John B. Lauer
7. Dr. Roland R. Renne
8. Raymond Shelkofsky
9. Theodore Nilsen
10. Arthur H. Rosen
11. A. David Drosnes
12. Jesse Goodman
13. Robert L. Simpson
14. Samuel J. Bookatz
15. Anne L. Avin

Paragon Electrical Manufacturing Corporation

16. William D. Stewart
17. A. J. Androus

Westfalls Shopping Center Limited Partnership

18. Fielder B. Downes

(f) With regard to the transactions enumerated in Item (e) above, and without limiting itself to the possibility that other bookkeeping violations occurred during this period, the Division states that the registrant failed to record them on the blotters (or other records of original entry) which contain an itemized

daily record of all purchases and sales of securities and registrant failed to reflect receipt and delivery of such securities, the receipt and disbursements of cash and all other debit and credit items in connection with the aforementioned transactions as alleged in Section II B(13) of the order.

(g) The misrepresentations and omissions represented by letters which correspond with the misrepresentations and omissions enumerated in Section II B(14) of the order, were allegedly made in respect of each of the securities listed below:

Infrared	(a) (b) (d) (f) (g) (i) (k)
Paragon	(a) (b) (c) (f) (g) (i)
DPC	(a) (b) (f) (g) (k)
Van Pak, Inc.	(a) (b) (d) (e) (f) (g) (h)
Roseville Detroit Limited Partnership	(e)
Apache Canadian Oil & Gas Program 1961	(a) (j) (l)

Finally, each of the violations alleged in the order for proceeding was committed "singly" by the respondents enumerated below:

As to Section II B(1) of said order, registrant, Hodgdon, Haight and Carr are so charged.

As to Section II B(2) registrant, Hodgdon, Haight, Carr, Kitain, Adam, Harper, Davis and Kibler are so charged.

As to Section II B(3) registrant, Haight, Carr, Kitain,

Adam, Harper, Davis, Kibler and Amann are so charged.

As to Section II B(4) registrant, Hodgdon, Haight, Carr, Kitain, Adam, Harper, Davis and Kibler are so charged.

As to Section II B(5) registrant, Haight, Carr, Kitain, Adam, Harper, Davis and Kibler are so charged.

As to Section II B(6) registrant, Haight, Carr, Kitain, Adam, Harper, Davis and Kibler are so charged.

As to Section II B(7) registrant, Amann, Kitain, Roper, Carr and Davis are so charged.

As to Section II B(8) registrant, Amann, Kitain, Roper, Carr and Davis are so charged.

As to Section II B(9) registrant, Hodgdon, Haight, Carr, Kitain, Adam, Harper, Davis, Kibler, Roper and Amann are so charged.

As to Section II B(10) registrant, Amann, Davis, Roper, Kitain, and Carr are so charged.

As to Section II B(11) registrant is so charged.

As to Section II B(12) registrant, Haight, Carr, Kitain and Baskin are so charged.

As to Section II B(13) registrant is so charged.

As to Section II B(14) the following respondents made misstatements or omissions with regard to the securities as set forth in that paragraph:

Infrared

Amann; Roper; Kitain

Paragon

Roper; Kitain; Carr

DPC

Amann; Kitain; Davis

Van Pak, Inc.

Hodgdon; Haight; Kibler; Kitain

Davis; Harper; Carr

Roseville Detroit
Limited Partnership

Kibler; Kitain; Davis;

Harper; Adam

Apache Canadian Oil
& Gas Program 1961

Harper; Roper

As to Sections II D and E registrant is so charged.

Dated: _____

Harold Webb

Wallace L. Timmeny

Counsel for the
Division of Trading and Markets

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC.

A. DANA HODGDON

JAMES F. HAIGHT

BURTON KITAIN

W. LYLES CARR, JR.

DAVID M. ADAM, JR.

JAMES W. HARPER, III

HOMER E. DAVIS

ROBERT F. KIBLER

LOUIS S. AMANN

JAMES L. ROPER

HARVEY E. BASKIN

File No. 3-533

ANSWER TO MORE DEFINITE STATEMENT

Dickstein, Shapiro & Galligan and Simpson Thacher
& Bartlett, answering the allegations of the More Definite
Statement on behalf of respondents Hodgdon & Co., Inc.,
A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles
Carr, Jr., David M. Adam, Jr., James W. Harper, III,
Homer E. Davis and Robert F. Kibler, state as follows:

1. Deny that the individuals named in the
first part of (a) thereof were employed as salesmen

without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business.

2. Deny that the individuals named in (b) thereof advised customers regarding the specified aspects of their finances without suitable training in such fields and without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business.

3. Deny that respondents induced customers, without regard to such customers' financial need and objectives, to sell seasoned securities out of their investment portfolio and reinvest the proceeds in unseasoned and speculative securities in which respondents had direct and indirect interests as identified in (b) thereof.

4. Deny that respondents offered and sold the securities of Paragon Electrical Manufacturing Corporation or Data Processing Corporation without inquiring into their background as alleged in (c) thereof.

5. Admit that there were no registration statements in effect for the securities of either Paragon Electrical

Manufacturing Corporation or Data Processing Corporation.

6. Deny that A. J. Androus failed to receive confirmation of the purchase of shares of Paragon Electrical Manufacturing Corporation, admit that confirmations were not sent to the other persons named in (e) thereof and that other entries as alleged in (f) thereof were not made with regard to the alleged transactions therein set forth, but deny that respondents thereby violated the Securities or Exchange Acts or Rules enacted thereunder.

7. Deny that respondents made untrue, deceptive and misleading statements of material fact and omitted to state material facts as alleged in (g) thereof.

8. Respondents repeat and reallege the denials set forth in their answer to the order for proceedings.

May 20, 1966

DICKSTEIN, SHAPIRO & GALLIGAN

By

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Washington, D. C. 20005

Attorneys for Respondent Hodgdon
& Co., Inc. and individual Re-
spondents Hodgdon, Haight, Kitain,
Carr, Adam, Harper, Davis and Kibler

SIMPSON THACHER & BARTLETT

By

Harry Heller
1700 K St., N. W.
Washington, D. C. 20006

Special Counsel for Said Respondents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
	:	
HODGDON & CO., INC., et al.	:	SUPPLEMENT TO MORE
	:	DEFINITE STATEMENT
(8-8427)	:	
	:	

The Hearing Examiner's order of April 25, 1966 grants in part the respondents' Motions for a More Definite Statement concerning matters alleged in the order for public proceedings pursuant to Sections 15(b), 15A and 19(a) of the Securities Exchange Act of 1934. The Division furnishes the following information which supplements the Division's More Definite Statement of May 10, 1966.

The names of the securities, in addition to those named in the Division's More Definite Statement of May 10, 1966 which the respondents induced their customers to purchase, as alleged in Section II B(4), included the securities of the following organizations:

29. Mohawk Business Machines, Inc.
30. Roseville Detroit Ltd., Partnership
31. Apache Realty Corp.
32. Transcontinental Investment Corp.
33. Tel-A-Sign, Inc.
34. Vahlsing Corp.
35. Major Finance Corp.
36. Edwards Engineering Corp.

- 37. Swimming Pool Development Corp.
- 38. Thoroughbred Enterprises, Inc.
- 39. Cooke Engineering Co.
- 40. Sheraton Corp. (Warrants)
- 41. Milo Electronics Corp.
- 42. Brothers Chemical
- 43. Automation Labs
- 44. Beauty Counselors

The name of respondent, in addition to those named in the Division's More Definite Statement of May 10, 1966 who induced customers to purchase Roseville Detroit Limited Partnership securities as alleged in Section II B(14) is James F. Haight.

Respectfully submitted,

Harold Webb

Wallace L. Timmeny

Attorneys for the Plaintiff
Securities and Exchange Commission

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:	
	:	
HODGDON & CO., INC., et al.	:	MOTION TO SUPPLEMENT
	:	MORE DEFINITE STATEMENT
(8-8427)	:	
	:	

The Division moves to supplement the more definite statement as follows:

The names of additional individuals who had little or no prior experience and were employed as salesmen for registrant without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business as alleged in Section IIB(1) were:

12. Louis S. Amann
13. Grier Sherrill
14. Harry F. Ware
15. Burton Kitain
16. W. Lyles Carr
17. David M. Adam, Jr.
18. James W. Harper, III

The names of additional individuals who advised customers regarding their finances including securities investments, real estate, taxation, trusts and wills, oil and gas, and insurance without suitable training in such fields and without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business as alleged in Section IIB(1) were:

8. John F. Saffer
9. Grier Sherrill
10. Louis S. Amann
11. William Flynn
12. David M. Adam, Jr.

The names of the securities, in addition to those named in the Division's More Definite Statement of May 10, 1966, and the supplement thereto, which the respondents induced their customers to purchase as alleged in Section IIB(4), included the securities of the following organizations:

45. Castaway Beach Motel
46. Wizard Boats of Tennessee
47. U. S. Photo Supply
48. Adler Built Homes
49. Techromatic Corp.
50. Space Tone Electronics
51. Tastee Freez Ind., Inc.

Respectfully submitted,

Harold Webb

Wallace L. Timmeny

Counsel for the
Division of Trading and Markets

Dated: _____

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of
HODGDON & CO., INC.

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

File No. 3-533

MOTION TO AMEND THE ORDER
FOR PUBLIC PROCEEDINGS

Pursuant to Rule 6(d) of the Commission's Rules of Practice, the Division moves to amend the Order for Public Proceedings filed herein, as follows:

(1) By adding to Section II B(14):

(n) the offer and sale of Van-Pak, Inc.
securities in the State of Virginia;

(2) By adding a new Section designated II B(15)
as follows:

make false and fictitious entries and aid
and abet the making of such entries on
the books and records of the registrant
in connection with the offer and sale
of Van-Pak, Inc. securities in the State
of Virginia.

- (3) By adding a new Section designated Section II E¹ as follows:

During the period of time referred to in paragraph B of Section II hereof respondents, Registrant Hodgdon, Haight, Kitain, Carr, Adam, Harper, Davis, Kibler, Amann and Roper, singly and in concert wilfully violated and aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that they made false and fictitious entries on books and records required to be kept under said rule.

Each of the violations alleged in Sections II B(14)(n) and II B(15) was committed singly by respondents, Hodgdon & Co., Inc., Hodgdon, Haight, Carr, Kitain, Adam, Harper, Davis and Kibler.

This amendment is proposed as a result of information brought to the attention of the Division since the institution of the Order for Public Proceedings.

Paul F. Leonard

Wallace L. Timmeny

Attorneys for the
Division of Trading and Markets

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC.

A. DANA HODGDON

JAMES F. HAIGHT

BURTON KITAIN

W. LYLES CARR, JR.

DAVID M. ADAM, JR.

JAMES W. HARPER, III

HOMER E. DAVIS

ROBERT F. KIBLER

LOUIS S. AMANN

JAMES L. ROPER

HARVEY E. BASKIN

File No. 3-533

MOTION FOR ORDER DIRECTING ALL FURTHER
PROCEEDINGS TO BE CONDUCTED PRIVATELY,
OR FOR ALTERNATIVE RELIEF

Come now Hodgdon & Co., Inc., A. Dana Hodgdon,
James F. Haight, Burton Kitain, W. Lyles Carr, Jr.,
David M. Adam, Jr., James W. Harper, III, Homer E. Davis
and Robert F. Kibler, respondents herein, and move

(1) for an order directing all further pro-
ceedings to be conducted privately or,

(2) in the event the Hearing Examiner deter-
mines that he does not have authority to grant

such relief, for an order certifying the question for interlocutory review by the Commission pursuant to Rule 12(a) of the Commission's Rules of Practice with a recommendation that the relief requested herein be granted.

Pending a hearing and determination of the within motion, respondents request that any further testimony in this proceeding be suspended.

Respondents further move that, in the event this matter be referred to the Commission, the undersigned be permitted to present oral, as well as written, argument.

As grounds for the within motion, respondents refer the Hearing Examiner to respondents' brief served and filed herewith.

June 16, 1966

DICKSTEIN, SHAPIRO & GALLIGAN

By David I. Shapiro
David I. Shapiro
1411 K St., N. W.
Washington, D. C. 20005

Attorneys for Respondent Hodgdon & Co., Inc. and individual Respondents Hodgdon, Haight, Kitain, Carr, Adam, Harper, Davis and Kibler

SIMPSON THACHER & BARTLETT

By Harry Heller
Harry Heller
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Washington, D. C. 20006

Special Counsel for Said Respondents

UNITED STATES OF AMERICA
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BRIEF FOR RESPONDENTS IN SUPPORT
OF MOTION THAT ALL FURTHER PROCEEDINGS
BE CONDUCTED PRIVATELY

Preliminary Statement

Upon request to the Hearing Examiner "in camera" for leave to apply to the Commission for an order directing all further proceedings in this matter to be conducted privately, and after consultation between the Hearing Examiner and the Secretary to the Commission, counsel advised they might "make any submission to the Hearing Examiner in writing or otherwise" that they deemed

necessary or appropriate.

By refusing to hear respondents' application in the first instance and advising that counsel might "make any submission to the Hearing Examiner in writing or otherwise" that was appropriate, it seems plain that the Commission has granted the Hearing Examiner power to order that all further proceedings in this matter be conducted privately. That power should be exercised as a matter of discretion now, inasmuch as a failure to do so will, as we shall show, cause further destruction to respondents' business, resulting in their being forced out of business.

Since every tribunal, whether administrative or legal, has inherent power to protect the subject matter of its jurisdiction and since, in the event of respondents' demise, this proceeding for all practical purposes will become moot, the Hearing Examiner should grant the relief requested herein.

I

The Hearing Examiner Should Issue an Order
Directing that all Further Proceedings
Be Conducted Privately

Comparison of the newspaper publicity given to the

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :

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File No. 3-533

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I

The Hearing Examiner Should Issue an Order
Directing that all Further Proceedings
Be Conducted Privately

Comparison of the newspaper publicity given to the

first day's testimony in this case with the transcript of that testimony shows that there is no reasonable relationship between what was reported and what is reflected in the transcript. While we do not propose, nor do we think it necessary, to set forth this comparison in detail, we do ask the Examiner to compare the newspaper stories in the "Washington Post" of June 15 (Ex. A^{1/}), the "Evening Star" of June 14 (Ex. B^{2/}), and the "Daily News" of June 15 (Ex. C^{3/}), with pp. 70-98 and 135-136 of the June 14 hearing transcript,^{4/} as well as Division's Exhibit 1.

Clearly, the Hearing Examiner has no authority to bar the press from a public proceeding, or to direct them to report testimony fairly or impartially, or to require that the testimony, whether favorable or unfavorable, be given less than "sensational" coverage. But this does not mean that the Hearing Examiner is without any power

1/ Annexed hereto.

2/ Annexed hereto.

3/ Annexed hereto.

4/ While we do not annex a copy of the hearing transcript, we do request that it be made a part of the record for the purposes of this motion.

in the premises, or that he can, consistent with due process, permit these proceedings to continue publicly in the face of a hostile press. Compare Sheppard v. Maxwell, ___ U.S. ___, 34 L.W. 4451, 4456-4460, decided June 6, 1966.

The issue here, of course, is not the possibility that the Hearing Examiner will become prejudiced against respondents as a result of hostile newspaper publicity,^{5/} but rather the impact of any publicity -- hostile or otherwise -- on respondents' business during the period in which they are seeking to vindicate themselves. And in this regard, it is fair to state that the testimony to date, far from proving the serious charges against them, has tended, so far, to exculpate them.

Everybody knows that the impact of an order for public proceedings upon the business of a broker-dealer is serious, if not fatal. In fact, in 1963, a subcommittee of the American Bar Association's Section of

^{5/} We do not exclude the existence of possible prejudice before the Commission since the Commissioners will not hear the witnesses and whatever impression, if any, they will have of this case at the time they eventually review it will be the result of whatever they have read in the press and in the Report of the Special Study.

Administrative Law reported that:

"Experience makes it clear that the effect of a public release upon a broker-dealer firm's business is disastrous. It loses both customers and personnel who, fearful of the ultimate results of the proceedings, seek employment elsewhere. Indeed, the economic effects upon the firm and its reputation as a result of the proceedings are often cited by the Commission as one of the determinants of the size of the penalty it will impose in the 'public interest.'" 15 ABA Admin. L. Rev. 188, 190 (1963).

How much more disastrous will be the impact from the continued day-by-day publicity of these proceedings where the Division plans to call 60 to 75 witnesses, whose testimony, from present indications, will be reported extensively?

The annexed affidavit of James F. Haight shows that since the order for public proceedings was made public in the local press on March 3, 1966, nine registered representatives have left the firm and eight others have indicated they will do likewise if publicity concerning these proceedings continues. Mr. Haight further avers that, during the period March 3 to June 12, 1966, approximately 100 customers have indicated a concern (by reason of the adverse publicity) about doing business with the firm or have refused to do so outright; that impairment of customer "goodwill" have resulted in loss of business

the firm otherwise would have had; and that, during the period June 13-June 15, approximately 50 additional customers have telephoned to express varying degrees of concern.

Since the volume of the registrant's business is dependent almost entirely upon customer "goodwill" and its ability to maintain the size and caliber of its group of registered representatives, the destruction of customer "goodwill" and the departure of more registered representatives will bring about financial losses that must result in the company going below its net capital requirements, thereby compelling total suspension of its operations.

At that point, although counsel are confident that respondents will eventually be vindicated, the Hearing Examiner and the Commission will be vindicating a corpse. At the point at which continued newspaper publicity will cause this firm to go below its net capital requirements, this proceeding, for all practical purposes, will become moot, and the press will have accomplished by publicity what, in our view, the Division can never accomplish by evidence.

In view of the foregoing, the Hearing Examiner should rule as a matter of discretion that all further proceedings be conducted privately.

II

There Is No Longer Any Reason for Requiring These Proceedings to Be Conducted Publicly

In denying respondents' prior motion to dismiss the order for public proceedings on the ground, inter alia, that the Commission had arbitrarily refused to conduct these proceedings privately, the Hearing Examiner pointed out that there were three main reasons for ordering that proceedings against broker-dealers be conducted publicly.^{6/} These were: (1) apprising investors that they might have causes of action prior to the running of the statute of limitations; (2) warning the investing public against the activities of the broker-dealer being proceeded against; and (3) encouraging witnesses to come forward and testify in the pending proceeding.

In our brief in support of the motion to dismiss we conclusively demonstrated that, inasmuch as (a) all investor

^{6/} Order Denying Motion to Dismiss, p. 3.

claims under the Securities Acts were barred in any event^{7/}
and (b) the alleged violations occurred during the period
May 1960 to June 1964 and there was no charge of present
or continuing misconduct, reasons (1) and (2) were in no
way applicable to this proceeding.^{8/}

The only other reason which could have justified
the holding of public proceedings in this case was that
witnesses, apprised of the institution of such proceedings,
would come forward and testify. However, since the Divi-
sion has informed us that, by reason of the publicity^{9/}
given to the order for public proceedings on March 3 and 4,
1966, witnesses have come forward and offered to testify,
all three reasons for holding public proceedings have been
substantially satisfied.

7/ Respondents offered, and continue to offer, to waive the
statute of limitations (1) in "common law" fraud actions in
jurisdictions where the statute of limitations has not yet
run and (2) in actions based on violations of those sections
of the Securities Acts for which no express limitation period
is provided (Res. Br. in Support of Motion to Dismiss, p. 7).

8/ Res. Br. in Support of Motion to Dismiss, pp. 3-4, 6-8.

9/ See the newspaper stories in the "Washington Post" for
March 4, 1966 and the "Evening Star" for March 3 and 4,
1966, as well as Ex. A annexed to Respondents' Brief in
Support of the Motion to Dismiss, i.e., the newspaper story
in the "Daily News" for March 4, 1966.

Since there is no longer any significant justification for continued public proceedings, a continuation of such proceedings can only serve the "indefensible" purpose of "punishing" respondents by publicity -- a result which does not comport with due process. Watkins v. United States, 354 U.S. 178, 187 (1957).

III

The Nature of the Alternative Relief Requested

While, in our view, the Commission has clearly indicated that the Hearing Examiner does have power to grant the relief respondents seek, we do not discount the possibility that the Hearing Examiner may think otherwise. Accordingly, in the event the Hearing Examiner believes himself without authority in the premises, we request that he certify the matter for interlocutory review by the Commission together with appropriate findings and a recommendation that the relief requested be granted.

The Hearing Examiner's recommendation is important because, having heard and seen the witnesses, he is in a better position than the Commission to compare the testimony with the "publicity" meted out to respondents and to determine, in the first instance, the appropriate remedy.

Since the press undoubtedly will continue its "sensational" reporting of the most innocuous testimony, respondents respectfully request that all further testimony be suspended pending a hearing and determination of the within motion.

Conclusion

By reason of the foregoing, respondents' motion should be granted.

June 16, 1966

Respectfully submitted,

DICKSTEIN, SHAPIRO & GALLIGAN

By

David I. Shapiro
1411 K St., N. W.
Washington, D. C. 20005

Attorneys for Respondent Hodgdon & Co., Inc. and individual Respondents Hodgdon, Haight, Kitain, Carr, Adam, Harper, Davis and Kibler

SIMPSON THACHER & BARTLETT

By

Harry Heller
1700 K St., N. W.
Washington, D. C. 20006

Special Counsel for Said Respondents

AFFIDAVIT

DISTRICT OF COLUMBIA, ss:

James F. Haight, being duly sworn, deposes and says:

1. I am one of the individual respondents in this proceeding as well as President of the corporate respondent herein.

2. Since March 3, 1966, the date on which the local press first reported the issuance by the Commission of the order for public proceedings in this case, the following registered representatives have left Hodgdon & Co., Inc.:

- (1) Warren Moore (with firm 7 years) --
left March 17, 1966
- (2) Marcus P. Horn (with firm 1 year) --
left March 24, 1966
- (3) Charles K. Matheny (with firm 7 years) --
left April 1, 1966
- (4) Grover Rees (with firm 4 years) --
left April 1, 1966
- (5) James P. Fristoe (with firm 1 year) --
left May 10, 1966
- (6) Leslie Phillips (with firm 5 years) --
left May 13, 1966
- (7) Manuel de Pinho (with firm 18 months) --
left May 19, 1966

(8) John Farley (with firm 5 years) --
left June 1, 1966

(9) Fred Repass (with firm 18 months) --
left June 1, 1966

3. During the period March 3 through June 12, 1966, approximately 100 customers telephoned the firm either to express their concern about doing business with the firm as a result of the adverse publicity or to refuse outright to do any more business with the firm.

4. During the same period, I estimate that the firm has lost substantial other business it would have obtained were it not for the order of public proceedings and the resulting publicity thereon.

5. During the period June 13 through June 15, 1966, eight more registered representatives have either advised me or others in the firm that, if the press continues to publicize the proceedings herein, they will have to leave the firm.

6. Unless the relief requested by respondents herein is granted, the corporate respondent will continue to suffer irreparable injury and will eventually be caused to be in violation of its net capital requirements, resulting

in a complete suspension of its business operations.


James F. Haight

Subscribed and sworn to before me this 16th day of
June, 1966.


Notary Public

My Commission Expires - 12/31/70

Business & Finance

WEDNESDAY, JUNE 15, 1966

SEC Hearing Opens

Risky Stock Deals Of Hodgdon Bared

By Paul G. Edwards

Washington Post Staff Writer

Two witnesses testified yesterday at a Securities and Exchange Commission hearing that the Washington brokerage firm of Hodgdon & Co. underwrote securities of two companies with highly risky prospects and products.

The leadoff witness was Frey C. Johns, a former salesman for Hodgdon, which now operates under a revised management lineup as Hodgdon, Haight & Co.

He said that he was fired from the firm in 1962 for refusing to participate in underwritings of securities of Van Pak, Inc. and United States Infra Red Corp.

A principal product of U.S. Infra Red was a heat detection device that he said was described to him by engineering experts as not worthy of serious promotion.

He said these expert opinions were passed on to a Hodgdon officer before the underwriting.

SEC lawyers called one of these experts, consulting physicist Dr. Francis Rawden Smith, who confirmed that he found the Infra Red product to hold little promise.

In cross examination of Johns, defense lawyers for Hodgdon tried to show that he is biased against the defendants because of his dismissal from the firm.

Johns said under direct

examination that Dana Hodgdon, former board chairman of the firm, fired him after his refusal to recommend Van Pak securities. Johns said that despite optimistic earnings predictions by Van Pak executives, the company prospectus indicated it was insolvent at the time of the offering in 1962.

He described a sales meeting at which Hodgdon said the Virginia Securities Commission would not permit the sale of Van Pak securities in Virginia on the grounds that the company was insolvent.

Johns said Hodgdon called the State's law "archaic" and then told his salesmen that they should use Maryland and Washington addresses for the stock.

Staff charges against the brokerage firm fall under the anti-fraud provisions of the Federal securities laws. The hearings before Examiner Sidney Gross are expected to continue for weeks.

EXHIBIT "A"

The Evening Star

WASHINGTON, D. C., TUESDAY, JUNE 14, 1966

Fired Salesman Is Witness As Hodgdon Hearing Opens

By DONALD B. HADLEY

Star Financial Editor

Attorneys for Hodgdon, Haight & Co., Washington securities firm facing proceedings under anti-fraud provisions of the securities laws, punctuated testimony of the first witness with objections and finally were granted a recess till after lunch.

The Hodgdon attorneys said they needed the recess to gather material for cross-examination of the witness.

Appearing as a Securities and Exchange Commission witness, was Frey C. Johns, who said he was fired in 1962 from the Hodgdon firm for refusing to participate in underwritings he decided were too risky. He was interrupted many times by attorneys for the firm.

Johns, who later was a registered representative for Jonnstun, Lemon & Co., and now is a registered representative in the Washington office of Hayden, Stone, Inc., testified that prior to an underwriting of stock of United States Infrared Corp. in 1960, he consulted various electronic experts about the Infrared Gun, which among other things was believed to be useful in detecting railroad hot boxes.

Experts Consulted

Among the experts consulted, the witness named Dr. Frank Rawden Smith, a government consultant; George L. Erion, electronic engineer, owner of international rights for the Sidewinder missile, and Edmond L. Myerson, an electronic engineer.

The verdict of the experts was that the infrared invention was underdeveloped and was not yet worthy of serious promotion, the witness said. Louis S. Amann, Hodgdon vice president, was informed of their opinion, Johns said.

He quoted Dr. Smith as saying he considered the invention supposed to detect heat in box boxes to be "a masterpiece of insensitivity to heat."

Johns testified he did not participate in the infrared offering because he considered it to be "too high a risk."

He said that prior to an underwriting of Van Pak, Inc. stock, Dana Hodgdon, board chairman of the firm, told him the offering was vital to the interests of the firm, and in a subsequent memorandum warned Johns

that he did not want to sell the stock. Johns said he did not want to sell the stock because he had seen the prospectus and that it indicated the firm to be insolvent and an "extremely high risk." The witness said he told Hodgdon he did not want to sell the stock.

Later Hodgdon called him and told him he was fired, Johns added. Johns said Hodgdon told him he was through immediately.

The witness said Hodgdon accused him of failing to show enthusiasm for company offerings and failing to sell the company's real estate syndications.

Questioned about sales meetings prior to the Van Pak underwriting, Johns said Van Pak officials described the company's plans, hopes and aspirations and predicted a sharp rise in earnings.

Virginia Action

At one of the meetings Hodgdon also told of a trip to Richmond to discuss the underwriting with the Virginia Securities Commission, Johns said. Hodgdon reported the Virginia commission refused to permit sale

of the shares in Virginia because of a state law prohibiting the sale of the stock of an insolvent company and described the law as "archaic," the witness testified.

Johns said Hodgdon told his salesmen that if any of them sold the shares to Virginia residents they could always use Maryland or District of Columbia addresses.

The SEC staff entered into the hearing record a number of depositions and statements of Johns relating to his relations with the firm, including his final discharge.

Throughout his testimony, Hodgdon attorneys objected at almost every point on various grounds, most commonly on grounds of hearsay evidence.

Sidney Gross, hearing examiner, allowed some but disallowed others.

Upon completion of the Johns initial testimony, Hodgdon attorneys asked for a recess to permit examination of the testimony and exhibits and prepare for cross-examination.

Gross offered a recess of 10 minutes but this was protested strongly and a recess to 2 p.m. was proposed. Gross allowed until 1 p.m.

The initial hearing started at 10 a.m. and lasted just one hour, but the proceedings are expected to last through the summer because of a long list of witnesses to be heard. Some say more than 75.

Exhibit "B"

Washington Business

Ex-CIA Man Testifies in Hodgdon Case

By RICE ODELL

A former CIA agent turned stockbroker was the first witness yesterday as the Securities & Exchange Commission began presenting evidence to support its long and complex charges against the Washington brokerage firm, Hodgdon & Co.

He was Fray C. Johns, a handsome, 42-year-old blond who lives at 1020 Slipman Lane, McLean, and who worked as a salesman for the company from 1958-62 after nine years with the CIA.

Mr. Johns who is now with Hayden Stone, Inc., is one of more than 60 witnesses thru whom the SEC intends to prove its allegations that the firm and officers of it were involved in the fraudulent sale of dozens of stocks, including some in which they had special interests.

Among 44 securities listed in the complaint are several theatrical ventures of A. Dana Hodgdon, founder and former board chairman who resigned all interests several months ago, according to an announcement. The name was changed to Hodgdon, Haight & Co.

EXPERTISE

Mr. Johns' testimony was directed principally at the stock of U.S. Infrared Corp., one of those which the SEC claims was sold thru "deceptive and misleading" statements.

Infrared was a small area firm whose head, Patrick McCarthy, had developed an infrared gun claimed to be useful in detecting "hotboxes" on railroad cars.

Mr. Johns testified that in August, 1960, Louis A. Amann, a Hodgdon vice president at the time and one of 11 men named in the complaint, "asked me if I be interested to raise some money for a private underwriting for the firm."

He said there were several meetings at which Mr. McCarthy demonstrated the gun, and he had invited several experts and clients for an appraisal. Among these were Dr. Francis Rawdon Smith, an electronics engineer with his own consulting firm here, and George L. Erick, who has international rights to the Sidewinder missile, also an infrared device which seeks out the heat of a jet's after burner.

MASTERPIECE

Mr. Johns said the gun was called by Amann, Erick and a few

bull overhead "It didn't work at that time," Dr. Smith, who lives in Frederick, testified later. "He (McCarthy) said it was simply out of whack." Later he said it failed to respond appreciably to a soldering iron.

Mr. Johns said the viewers felt in general that the invention was "underdeveloped, that it was not yet worthy of serious promotion." He said Dr. Smith called it a "masterpiece of insensitivity to heat."

"I made an added effort to determine the amount of risk," Mr. Johns said. Promoted by a year he spent working in the insurance business, he said, he "talked to Mr. McCarthy and found that due to high blood pressure and a heart condition he was uninsurable."

Participants said that Mr. McCarthy did, in fact, die of a heart attack several months later.

Mr. Johns testified that Infrared stock was sold thru the auspices of Hodgdon & Co.; and Dr. Smith said he later found out that Mr. Amann was an officer of Infrared.

'WRONG'

Mr. Johns also said that he was more or less fired by Mr. Hodgdon when he told him, in connection with another stock, that he "didn't like the underwriting because the prospectus showed the company to be insolvent."

He said that this insolvency prohibited its sale in Virginia under a law which Mr. Hodgdon called "archaic." He said Mr. Hodgdon told a group of salesmen to use D.C. or Maryland addresses if they sold it to Virginia residents.

Under cross-examination Mr. Johns admitted that in his selling he "tended to emphasize low-priced securities not recommended by the firm" (who their sale was authorized by it).

He said some other salesmen were selling them but he was not offering any excuses.

"The firm's in the market were such when there was a great amount of such low-priced stock," he said. "It was wrong, but in hindsight I was involved."

Exhibit "C"

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
June 17, 1966

ORDER

Re: Hodgdon & Co., Inc. et al.
(File No. 8-8427)

Broker-dealer Proceedings

Hodgdon & Co., Inc., A. Dana Hodgdon, James F. Haight, Burton Kitain, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis, and Robert F. Kibler have applied to the Commission, pursuant to Rule 12(a) of the Commission's Rules of Practice, for review of a ruling of the hearing examiner, which he certified to the Commission, denying their motion for an order directing that all further proceedings be conducted privately.

Applicants urged in support of their motion that newspaper publicity given to the testimony at the hearings did not reasonably reflect that testimony and that any publicity - hostile or otherwise - would have a serious if not fatal impact upon respondents' business. They further stated that since the proceedings began a number of registered representatives have left registrant and others have indicated they will leave if the publicity continues, that a large number of customers have indicated a concern about doing business with registrant or have refused to do so. Applicants also advanced contentions which they had previously made in support of a motion to dismiss the proceedings on the ground that the proceedings should have been private. The hearing examiner had denied that motion and on May 23, 1966, the Commission, after due consideration, refused to review such denial.

The hearing examiner, in denying applicants' motion for an order changing the proceedings from public to private stated that "the nature of the reporting in the press is something which cannot control the question whether a hearing should be public or private," and that counsel for applicants "can rely on the Hearing Examiner and the Commission to base a decision on the record in the proceedings and not on any newspaper articles."

The Commission, in determining whether to order public or private proceedings, weighed the general public interest and the interest of investors in the subject matter of the proceedings in the light of the nature of the charges presented against the respondents' interest in keeping the proceedings private. The Commission concluded that the former outweighed the latter and accordingly instituted public proceedings. Such determination obviously recognized that the hearings would be attended by press publicity because the issues affect public investors.

On the basis of the foregoing, it is concluded that neither the asserted differences between the transcript and the press reports nor the other factors cited by applicant warrant changing the nature of the proceedings from public to private.

Accordingly, the ruling of the hearing examiner denying applicants' motion to make the proceedings private is affirmed.

For the Commission (pursuant to delegated authority).

Orval L. DuBois

Orval L. DuBois
Secretary

ORIG
R/A

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
February 10, 1967

SECURITIES & EXCHANGE COM.
MAILED FOR SERVICE

FEB 10 1967

In the Matter of
Hodgdon & Co., Inc., et al.
(File 8-8427)

CTFD. NO. 864713
RULING ON REVIEW PETITION 864717

In the matter of the public proceedings under Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 pending in respect of Hodgdon & Co., Inc., et al. (8-8427), the Commission considered a petition by its Division of Trading and Markets, filed pursuant to Rule 12(a) of the Commission's Rules of Practice, for review of certain evidentiary rulings by the hearing examiner, which the latter refused to certify. Those rulings excluded as irrelevant certain portions of exhibits introduced in evidence by the Division. Hodgdon & Co., Inc. and certain individual respondents filed a memorandum in opposition to the petition.

Excluded from Division Exhibits 422, 424 and 426 and similar exhibits were references to the "market value" as of June 11, 1964, of certain securities which a customer either had acquired before dealing with respondents and sold on respondents' advice prior to that date or had purchased upon respondents' recommendation, and to unrealized losses or profits as of that date. The Division asserted that the market values as of such date which approximated the end of the period specified in the order for proceedings and was arbitrarily selected in analyzing investor-witness accounts were relevant to the allegations in Sections IIB(2) and (6) of the order.

Section IIB alleged that between May 1960 and June 1964, respondents willfully violated anti-fraud provisions of the Securities Acts in that they, among other things:

"(2) induced unsophisticated customers to repose complete trust and confidence in them causing such customers to believe that they would act in their best interests," and


"(6) caused such customers to retain their trust and confidence in respondents by means of lulling ... representations that they were better off because of the financial advice given by respondents, when, in fact, such customers had suffered losses or were no better off than before dealing with respondents."

After due consideration of the petition and respondents' memorandum, the Commission was of the opinion that the excluded portions of the exhibits might be relevant at least to Section IIB(2) of the order for proceedings. The Commission pointed out that in cases involving the charge of inducing excessive trading in the accounts of customers in violation of the trust and confidence reposed in the broker-dealer, it had considered relevant the value of the customers' original portfolio if left intact and unrealized losses at the end of a period in determining whether the broker-dealer had acted in their best interests. See Behel, Johnson & Company, Inc., 26 S.E.C. 163, 166 (1947); R. H. Johnson & Company, 38 S.E.C. 467 (1955), aff'd 231 F. 2d 523 (C.A.D.C., 1956), cert. denied 352 U.S. 844; Reynolds & Co., 39 S.E.C. 902, 907 (1960). Respondents contended that paragraph IIB(2) was tantamount merely to an allegation that respondents undertook to recommend suitable transactions and that suitability could not be judged by market prices at a date long after the transactions since a broker-dealer is not an insurer. The Commission was of the opinion, however, that subsequent market prices may be a factor together with other relevant circumstances in determining whether as alleged in that paragraph the broker-dealer acted in the customers' best interests.

With respect to the issue raised in paragraph IIB(6), the Commission noted that it did not appear when the alleged lulling representations were made to the customers involved. The Commission therefore did not determine whether the excluded portion of the exhibits would be relevant with respect to that issue. In this connection, however, it pointed out that the hearing examiner and the Commission could take official notice of the prices at which listed securities were traded and unlisted securities quoted on any dates that might be relevant.

Finally, the Commissioner observed that the generally accepted view favors liberality in the admission of evidence in administrative proceedings if it "in some degree advances the inquiry" (McCormich, Handbook of the Law of Evidence 319 (1954)) or "can conceivably throw any light upon the controversy" (Samuel H. Moss, Inc. v. F.T.C., 148 F. 2d 378, 380 (C.A. 2, 1945), cert. denied 326 U.S. 734), and that at the conclusion of the proceedings it would carefully appraise both the admissibility and the weight of the evidence in question on the basis of the whole record and in the light of any further legal argument.

The Commission accordingly reversed the hearing examiner's rulings. Commissioner Budge dissented from this action (see attached).


Orval L. DuBois
Secretary



Hodgdon & Co., Inc., et al.

Commissioner Budge dissenting:

As the opinion of the majority indicates, the petition here considered reaches the Commission pursuant to Rule 12(a) of the Commission's own Rules of Practice. That rule reads as follows:

"Rule 12. Interlocutory Review; Motions and Applications to Commission.

(a) Review of hearing officer's rulings. The Commission will not review a ruling of the hearing officer prior to its consideration of the entire proceeding in the absence of extraordinary circumstances. Except as provided in Rule 11(c), a hearing officer shall not certify a ruling for interlocutory review by the Commission unless a party so requests and (1) the hearing officer finds, either on the record or in writing, that in his opinion a subsequent reversal of his ruling would cause unusual delay or expense, taking into consideration the probability of such reversal, or (2) his ruling would compel testimony of Commission members, officers or employees or the production of documentary evidence in their custody. The certification by the hearing officer shall be in writing and shall specify the material relevant to the ruling involved. The Commission may decline to consider the ruling certified, if it determines that interlocutory review is not warranted or appropriate under the circumstances. If the hearing officer does not certify a matter, a party who had requested certification may apply to the Commission for review, or the Commission on its own motion may direct that any matter be submitted to it for review. An application for review shall be in writing and shall briefly state the grounds relied on. Review will not be granted unless the Commission concludes that the hearing officer erred in failing to certify the matter. Unless otherwise ordered by the hearing officer, the hearing before the hearing officer shall continue whether or not such certification or application is made. Failure to request certification or to make such application will not waive the right to seek review of the ruling of the hearing officer after the close of the hearing pursuant to Rules 16(d) and 17. The Commission will prescribe the procedure for each application hereunder and paragraph (c) of this rule shall not apply."

/Emphasis mine./



I have examined the petition and the briefs and find not only that they are devoid of any showing as to compliance with Rule 12(a) but that they do not even discuss the rule.

It seems apparent to me that under Rule 12(a) there should be no review by the Commission absent extraordinary circumstances, and none have even been suggested.

Also, the rule specifically provides that "Review will not be granted unless the Commission concludes that the hearing officer erred in failing to certify the matter." But "...a hearing officer shall not certify a ruling...unless...(1) the hearing officer finds...that in his opinion a subsequent reversal of his ruling would cause unusual delay or expense, taking into consideration the probability of such reversal, or (2) his ruling would compel testimony of Commission members, officers or employees or the production of documentary evidence in their custody." By this rule the Commission has provided that the hearing officer must find either (1) or (2) above or he "shall not certify." It then provides "Review will not be granted unless the Commission concludes that the hearing officer erred in failing to certify the matter." How it can be said that the hearing officer in this instance erred in failing to certify, I do not know. The record is completely devoid of any showing of compliance with the conditions precedent [(1) and (2) above]. I find no indication that anyone has even suggested that either (1) "a subsequent reversal of his ruling would cause unusual delay or expense" or (2) "his ruling would compel testimony of Commission members, officers or employees or the production of documentary evidence in their custody."

In my view, the opinion of the majority not only completely disregards our own rule that we will not review in the absence of extraordinary circumstances, but it reverses the hearing officer for failing to certify even though the rule specifically requires him to make a finding before certification, which finding it is impossible for him to make. On what would such a finding be based?

The reversal here seems to me to be a perfect example of the need for the Rule 12(a), and I see no reason to ignore it.

PAGES JA 124 THROUGH JA 129

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of	:
HODGDON & CO., INC.	:
(8-8427)	:
A. DANA HODGDON	:
JAMES F. HAIGHT	:
BURTON KITAIN	:
W. LYLES CARR, JR.	:
DAVID M. ADAM, JR.	:
JAMES W. HARPER, III	:
HOMER E. DAVIS	:
ROBERT F. KIBLER	:
LOUIS S. AMANN	:
JAMES L. ROPER	:
HARVEY A. BASKIN	:

INITIAL DECISION

Before: Sidney Gross, Hearing Examiner

Appearances: Sidney Dickstein and David I. Shapiro of Dickstein, Shapiro and Galligan and Harry Heller of Simpson, Thacher & Bartlett for Hodgdon & Co., Inc., now known as Haight & Co., Inc., A. Dana Hodgdon, James F. Haight, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper, III, Homer E. Davis and Robert F. Kibler.

Louis E. Shomette, Jr. for Louis S. Amann.

Robert B. Hirsch and Allen G. Siegel of Arent, Fox, Kintner, Plotkin & Kahn for Harvey A. Baskin.

Paul F. Leonard, Harold Webb, Wallace L. Timmeny, William R. Schief, Barton H. Finkelstein and Herbert E. Milstein for the Division of Trading and Markets.



This proceeding is brought pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), by order of the Securities and Exchange Commission ("Commission") dated March 2, 1966, to determine what, if any, remedial action is appropriate in the public interest as a result of alleged willful violations of the securities laws during the period from approximately May 1960 to June 1964 ("the relevant period") with respect to Hodgdon & Co., Inc., now known as Haight & Co., Inc. ^{1/} ("registrant") and various of its officers, directors and registered representatives.

The order for proceedings contains a multitude of charges. Taken together with the "More Definite Statement" filed by the Division of Trading and Markets ("Division"), the order alleges that during the relevant period the respondents, singly and in concert, willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 15c1-2, and 15c1-4 thereunder. ^{2/}

^{1/} Registrant's name was changed, as of June 1, 1966, to Hodgdon, Haight & Co., Inc. Its name was further changed, as of September 30, 1967, to Haight & Co., Inc.

^{2/} The composite effect of Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10-5 and 15c1-2 thereunder, as applicable to this case, is to make unlawful the use of the mails or means of interstate commerce in connection with the purchase or sale of any security by the use of a device to defraud, an untrue or misleading statement of material fact or any act, practice, or course of business which operates or would operate as a fraud or deceit upon a customer, or by the use of any other manipulative, deceptive or fraudulent device. Rule 15c1-4 includes, within the meaning of the phrase "manipulative, deceptive or fraudulent device," the failure of a broker or dealer, at or before completion of each security transaction, to furnish the customer written notification disclosing, in effect, whether it is acting as broker for the customer, as dealer for his own account, as broker for some other person or as broker for both the customer and some other person.

Sections 5(a) and 5(c) of the Securities Act; 3/ Section 17(a) of the Exchange Act and Rule 17a-3 thereunder; 4/ Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder; 5/ and Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder 6/ and willfully aided and abetted violations of all the aforementioned sections and rules. 7/

During the course of the hearing, on the Division's motion, the order for proceedings was amended

- (1) to add subdivision (N) to Section IIB(14) to allege
that registrant's customers were not advised that
registrant was not authorized to sell the stock of

3/ Sections 5(a) and 5(c) of the Securities Act, as applicable here, make it unlawful to use the mails or interstate facilities to sell or deliver a security unless a registration statement is in effect as to such security.

4/ Section 17(a) of the Exchange Act, as pertinent here, requires brokers and dealers to make and keep current such books and records as the Commission may prescribe as necessary and appropriate in the public interest or for the protection of investors. Rule 17a-3 specifies the books and records which must be maintained and kept current. The requirement that records be kept "obviously intends that such records be true records, and that the entries shall not be false or fictitious." Lowell, Neibuhr & Co., Inc., 18 S.E.C. 471, 475 (1945); John T. Pollard & Co., Inc., 38 S.E.C. 594 (1958); Continental Bond & Share Corporation, Securities Exchange Act Release No. 7135 (September 9, 1963).

5/ As relevant here, Section 15(c)(2) and Rule 15c2-4 require a broker or dealer participating in a distribution of securities to promptly transmit the money or other consideration received to the persons entitled thereto.

6/ Section 15(b) and Rule 15b3-1 require a broker or dealer to promptly file a correcting amendment to his application for registration if any information contained therein is or becomes inaccurate.

7/ Apart from the fraud allegations, not all respondents are charged in respect of each allegation.

Van Pak, Inc. within the State of Virginia and the reasons therefor; and

- (2) to add a new section designated Section IIB(15) to allege the making of false and fictitious entries by registrant in connection with the offer and sale of Van Pak, Inc. securities in the State of Virginia, and
- (3) to add a new subdivision IIE(1) to allege that during the relevant period all the respondents except Harvey E. Baskin, singly and in concert, willfully violated and aided and abetted violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder in that they made false and fictitious entries in books and records required to be kept under said rule with regard to the sale of Van Pak, Inc. stock in the State of Virginia.

All respondents were represented by counsel. Proposed findings of fact and conclusions of law and briefs have been filed by the Division and on behalf of all respondents. Division has also filed a reply brief.

On the basis of the record in the proceeding, including the documentary evidence, the testimony of the witnesses and the proposed findings of fact and conclusions of law, the Hearing Examiner makes the following findings and conclusions.

The Respondents

Hodgdon & Co. was organized by A. Dana Hodgdon ("Hodgdon") as a sole proprietorship in 1955. It maintained its offices in Washington, D.C. In 1956 it became a partnership consisting of Hodgdon,

his wife and W. Lyles Carr ("Carr"). Registrant was incorporated in 1960 and registered as a broker and dealer with the Commission on May 1, 1960. Registrant is a member of the National Association of Securities Dealers ("NASD") and the Philadelphia-Baltimore-Washington Stock Exchange ("PBW").

Subsequent to registrant's incorporation and during the relevant period Hodgdon was registrant's president, treasurer, a director and the major holder of registrant's stock. Before commencing business as a sole proprietorship Hodgdon had been employed for about three years as a registered representative by two member firms of the New York Stock Exchange ("NYSE").

Jazes F. Haight ("Haight") was employed by Hodgdon & Co. in 1957. Prior thereto, between 1952 and 1954, he was employed by a securities dealer engaged in the sale of mutual funds and a plan for acquiring the stock of a local utility company. He became a 1% partner of Hodgdon & Co. in 1958. Upon registrant's incorporation he was made a vice-president in charge of sales and training and a director. Haight instituted the basic training course for new salesmen which will be discussed below and delivered about 80% of the lectures in that course. In 1963 he was appointed executive vice-president and assumed additional executive duties to be exercised in Hodgdon's absence. He was also a registered representative.

Carr, as indicated above, became Hodgdon's partner in 1956. He had no previous experience in the securities business. Upon registrant's formation he became senior vice-president, secretary and a member

of the board of directors. He also owned 10% or more of registrant's stock. Carr lectured during the training course for new salesmen on sales techniques and real estate. Together with Hodgdon and Haight, Carr regularly interviewed applicants for employment with registrant as salesmen. He was also a registered representative.

Louis S. Amann ("Amann") joined Hodgdon & Co. as a registered representative in 1956. Before coming to registrant he was a salesman and officer of a registered broker-dealer for about 3½ years. He became a vice-president and director of registrant in 1960 upon registrant's incorporation and held 1% of registrant's stock. In July 1961 Amann resigned, involuntarily, from registrant. He was re-employed as a salesman by registrant within several months thereafter and continued as a registered representative until October 1965.

Burton Kitain ("Kitain") commenced employment with Hodgdon & Co. in 1959. Apart from a five or six month training program with a member firm of the NYSE he had no earlier association in the securities field. In September 1960 registrant appointed Kitain manager of its newly opened branch office in Bethesda, Maryland. He continued in that capacity until August 1964 when the branch office was closed.

David M. Adam, Jr. ("Adam") was employed by registrant in 1960. His prior experience was limited to a training course with a firm engaged in the sale of mutual funds for some months prior to joining registrant. He became ^{an assistant} vice president of registrant early in 1963. Prior thereto, in 1962, Adam had been selected as registrant's specialist in the field of research and analysis of securities and was also appointed

a group manager. The system of group managers was introduced to registrant in or about 1962. It was intended to reduce the need for constant direct communication between the salesmen and top management through the development of middle management but was short-lived.

James W. Harper III ("Harper") joined registrant in 1961. Earlier, he had been a trainee with a NYSE firm. He became a registrant representative and, thereafter, in 1962, a co-specialist in oil and gas investments. He also lectured on such investments during the training programs. In 1963 he was appointed assistant vice-president.

Henry A. Baskin ("Baskin") commenced employment with registrant in the fall of 1961 without any previous experience in the securities business and became a registered representative. In February 1963 he was appointed assistant to the president. In December 1963 he acquired something less than 3% of registrant's stock. Baskin resigned from registrant in June 1964. Registrant purchased his stock.

Homer E. Davis ("Davis") had no experience in the securities business before he joined registrant in 1957 as a registered representative. He was transferred to registrant's Bethesda office when it opened. Davis' name appeared on a list of specialists posted by registrant for its salesmen's use, as a specialist in real estate.

Robert F. Kibler ("Kibler") started his association with registrant in 1960 without previous securities experience. He is a

8/
registered representative.

I. REGISTRANT'S PRACTICES AND COURSE OF BUSINESS

Throughout the relevant period Hodgdon was in overall charge of registrant's operations. 9/ From the outset it was Hodgdon's philosophy that "there never developed a tradition of financial planning on the part of Wall Street vis-a-vis the public." In his view, as he communicated it to registrant's salesmen during training course lectures, an investment program should be predicated upon the concept of financial planning which should include among its goals protection against inflation through ownership of equities whether in the form of common stocks or equities in real estate; diversification, in order to insure safety; professional supervision of investments; and the need for discipline so that investors would hold their investments and maintain periodic investment plans.

Registrant's initial approach to a potential customer would propose that he become a financial planning client. This would require that he furnish the salesman complete information regarding his financial condition including his life insurance and securities portfolio, his income, his family responsibilities and ultimate investment objectives. Such data was usually acquired by having the customer fill out registrant's

8/ James L. Roper ("Roper"), the remaining respondent named in the order for proceeding, failed to file an answer as required by the order and was in default. Accordingly, the Commission issued an order barring Roper from future association with a broker or dealer; Securities Exchange Act Release No. 7895, May 27, 1966.

9/ Registrant used the mails and means and instruments of interstate commerce while engaged in the offer and sale of securities referred to herein.

"Confidential Financial Planning Worksheet". The ultimate financial plan was predicated on the customers' investment funds and objectives.

The financial planning concept, as described to registrant's clients, contemplated that the client would follow a ratio system pursuant to which he would place at least 50% of his investment funds in professionally managed securities, i.e., mutual funds, the top category. The remaining 50% would be divided between "blue chips," real estate syndications and programs for the development and operation of gas and oil leaseholds, all of which constituted the middle category, and "speculations" or "special situations" which made up the last category. Usually the ratio figures for the middle and last categories were fixed at about 40% - 10% or 30% - 20%. 10/ It was intended that the ratios remain flexible, depending upon the client's preferences and predilections in securities investments.

Prospective salesmen were interviewed for employment by Hodgdon, Haight, and Carr. Most of the salesmen recruited by registrant had no previous experience in the securities field. Registrant's predecessor had instituted a formal basic training course which registrant continued. It was mandatory that salesmen attend. The course was given over a period of about two months, five days a week and about two hours each day. The purposes of the course, generally stated, was to acquaint salesmen with the rules governing the sales of securities including the statutes, rules of conduct, the rules of the NASD and

10/ Hereafter, references to the ratio system in terms, for example, of 50-30-20 will refer to the various categories in the order described above.

to prepare them for the NASD examination. It also included instruction in mutual funds, sales techniques and, of course, the philosophy behind financial planning. Salesmen were paid no compensation and were not permitted to sell securities until they had passed the NASD examination. Haight taught most of the basic training course supplemented by an occasional lecture by Hodgdon, who made it a point to address every basic training course on his financial planning concept, by Carr and by outside talent brought in by registrant.

Following the basic training course salesmen were offered an advance training course. Here the lectures were given primarily by persons in the registrant's firm designated as "specialists" in their particular field.

With one exception 11/ the "specialists" had become such by exhibiting, while at registrant, an interest in their respective fields and by extensive reading. None had actual experience in their fields other than that acquired through their activities at registrant. These areas included real estate, trusts, estates, wills, taxation, gas and oil and insurance. The advanced training course emphasized the tax savings to be realized from investments in real estate partnerships and corporations, gas and oil developments, the judicious use of charitable trusts and wills and, depending upon the circumstances, the treatment of existing life insurance policies in order to make additional funds available for investment purposes.

11/ Terrence J. Smith, who had been a life insurance agent prior to joining registrant.

The latter could be accomplished either through loans on the policies, the taking of cash surrender values or the modification of policies to reduce premium payments, presumably without loss of adequate coverage.

Continuing training was also part of registrant's regular Tuesday morning sales meetings where, in addition to the discussion of registrant's securities business, its salesmen were exposed to lectures on new subject matter or on old subjects where management deemed a refresher to be in order. Management also offered to their salesmen the opportunity to take courses offered by outside institutions at registrant's expense.

Primary attention during the salesmen's course of training was given to acquiring the financial planning customer. 12/ The salesmen were required to make at least forty cold calls each day and to set up at least two interviews each day with prospective customers. Names of prospective customers were obtained from directories, including those of government agencies. A "canned" presentation was prepared for the initial telephone contact which was directed solely toward obtaining an interview. At the interview the entire financial planning concept was presented as a unique service. Prospective customers were informed of the availability of specialists in the various fields and the availability of all types of securities. The techniques employed here including the seeking for information as to the prospect's complete financial resources make it readily apparent that the entire procedure was designed to attract the naive and unsophisticated investor.

12/ The terms "customer" and "client" are used interchangeably.

Moreover, certain aspects of the advice and instructions offered to registrant's salesmen by Carr and Haight during the lectures promulgated a fraudulent course of conduct in the offer and sale of securities. Carr's instruction to new salesmen, many of whom were completely inexperienced, that where a customer desires to cancel an order the salesman is to say, "sure you can cancel if you like, but I think it is good. In fact, I think you should have doubled your order" ^{13/} is, manifestly, a direction to preserve the sale under any circumstances and teaches a flagrantly improper practice. Carr's further instruction that customers requesting a prospectus before making a purchase be put off with the suggestion that they buy first and cancel later if they wish, is equally outside the bounds of fair dealing. The purpose of the prospectus is to furnish the investor with information which may form the basis of an investment judgment, not from the point of view of one who has already purchased the security, but unfettered by the necessity of reversing his decision if the prospectus does not meet his expectations. Haight's teaching to salesmen to give only those facts necessary to close a sale, but not all the facts, is manifestly inconsistent with the requirements for full disclosure.

Registrant extensively advertised its financial planning concept during the relevant period through sponsorship of a news program over radio station WGMS in Washington, D.C. Some of its

^{13/} Carr's instruction on this subject lacks any reference to the nature of the security, its suitability for the customer or any other factor which may be pertinent to a considered investment judgment.

broadcasts stated that registrant has been sponsoring WGMS news five days a week. The broadcasts included references to registrant's staff of experts; to its expertise in financial planning; to its vast experience in the financial field; to its men as thoroughly experienced in financial planning; to its trained investment analysts; to its research staff; and to its ability to avoid risk for its customers through its "clear knowledge of the present market and its future course." These advertisements were intended to cause prospective customers to believe that respondents had special skill, knowledge and experience in financial planning and the investment of securities. But each of the foregoing representations involve either deliberate misstatements, exaggeration or improper implications. "Registrant's staff of experts" and its "thoroughly experienced" men included salesmen who had no prior experience in the securities business before joining registrant and who were fresh from completion of their training courses. These were the same salesmen represented as having clear knowledge of the present market and its future course. Since its references to its vast experience in the financial field came in 1961, it was a patent exaggeration. Further, registrant admits it had no research staff.

Other general observations regarding the sincerity of registrant's policies and instructions may be made before reaching its transactions with specific customers. Despite registrant's instructions that if a customer's investment assets reach the neighborhood of \$100,000, recommendation should be made to him to consider employment

of investment counsel, there is no evidence that this was ever followed. Although it was represented to customers that "blue chip" securities would make up part of the middle area of their investment ratio, registrant was aware that the recommendation of such securities to clients by its salesmen was the exception rather than the rule. Indeed, on January 30, 1961, Carr and Haight issued a memorandum to "Officers - Hodgdon & Co., Inc." entitled "Thoughts for Discussion" which reflects registrant's attitude toward "blue chip" recommendations by its salesmen. It reads, in pertinent part:

1. Emphasis and Direction in the Individual Stock Area

- a. Listed - At present time representatives seem to be at a loss to recommend or to know how to go about finding individual listed stocks to recommend to clients or prospects who request them.

It is well understood by representatives that the individual "blue chip" area should be handled by the professional management of Investment Companies or thru the David Babson Investment Counseling firm. But in initial conversations with prospects it is important to be able to discuss intelligently selected listed securities.

We don't think a great deal of listed securities would be sold because 1) of low commissions and 2) greater emphasis in other situations, but, it would show that we didn't have only high commission situations.

Recommendation:

Occasionally short talks at meetings telling what "blue chip" securities the Investment Companies are buying and selling or what Hodgdon & Co. recommends. Information for such a meeting gained from Wiesenberger, etc. and more importantly thru personal contact with the funds.

Moreover, no valid reason appears for the inclusion of interests in gas and oil development leases in the same category with blue chips. Hodgdon defined a blue chip security as a share of a major corporation which has performed very well in the last five or ten years. Gas and oil development investments are highly speculative and unseasoned. There is little alternative to the conclusion that these securities 14/ were bracketed with blue chips to encourage the inference that they were of the same quality, especially by the inexperienced financial planning client who relied upon registrant for guidance.

It is arguable whether the interests in real estate limited partnership syndications 15/ were speculative. However, they undoubtedly were unseasoned and lacked blue chip characteristics.

Although the main thrust of registrant's appeal to customers was its financial planning concept, registrant made no attempt to supervise its financial planning accounts to assure that its registered representatives were adhering to the ratio systems which they had established for their clients or were otherwise pursuing registrant's policies in respect of such accounts. Haight's responsibilities included supervision of salesmen. The extent of his supervision, however, was to review summary worksheets he directed the men to file and to review order tickets, both from an activity point of view. Manifestly, his principal interest was to assure that the salesmen were working hard enough, doing enough business. He admits that registrant

14/ Registrant was part of the selling group of the gas and oil programs it recommended.

15/ All such interests were new issues of which registrant was the underwriter.

had set up no machinery which would enable it to ascertain whether the financial plans were being properly administered. Salesmen were required to present financial plans for review only for the first year after completion of the basic training course. Thereafter, the submission for review of such plans as may have involved complex problems was left to the salesmen's discretion. Specialists' and group managers' activities were unsupervised.

Nor did Hodgdon attempt to supervise financial plans. His activities were directed primarily toward supervision of the firm's trading, the consideration of all offers for underwritings and the daily review of order tickets.

In November 1962 registrant instituted a sales quota requiring salesmen to sell \$18,000 in mutual funds or earn net commissions "to himself" of \$600 per month from the sale of "high-quality," as defined by registrant. Memoranda were distributed by registrant containing lists of securities for the salesmen's consideration. The lists consisted, substantially, if not almost entirely, of securities in registrant's trading account. Although the sales quota memorandum included a supplement stating that it was not intended to cause the representative to feel any undue pressure and was directed primarily to those who "are not working", the message was clear.

During the relevant period real estate offerings were one of registrant's major activities including both interests in real estate limited partnership syndications and real estate stocks. Between 1960 and 1964 registrant was the underwriter or a participant in a selling group of issues totalling about \$21,000,000. Of that amount

real estate limited partnership syndications represented about \$8,000,000 and real estate stocks about \$6,000,000.

Because of the extensive purchases by registrant's financial planning and other customers of real estate syndications arising out of salesmen's recommendations and representations as to the "yield" or "income" or "return" which the customer might expect to receive from such investments, it is advisable to consider, at this time, the propriety of these representations. 16/ Some of the real estate partnership syndications principally involved here and the dates of their respective prospectuses are:

Rock Creek Forest Apartment Associated ("Rock Creek"),
March 31, 1961

Falls Plaza Limited Partnership ("Falls Plaza")
March 31, 1961

Toledo Plaza Limited Partnership ("Toledo Plaza"),
June 15, 1961

Cheverly Terrace Limited Partnership ("Cheverly Terrace"),
February 8, 1962

Westfalls Shopping Center Limited Partnership ("Westfalls"),
July 20, 1962 17/

The impetus to investment in real estate is found in the provisions of the Internal Revenue Code permitting the use of accelerated depreciation on real property and the deduction of such depreciation in determining Federal income taxes. The prospectuses of the above-named syndications disclose that each proposes to take the advantage offered by accelerated depreciation, thus providing

16/ Real estate stocks will be discussed hereafter, as the occasion arises.

17/ Registrant was the underwriter of each of these issues. Other syndications will be discussed infra.

for a substantially larger cash flow for distribution to its investors than would otherwise be available.

But this cash flow is not entirely income in the accepted sense. Instead, it is made up, in whole or in part, of a return of capital which is free from Federal income taxes. The Special Study 18/ had occasion to distinguish between cash flow and income:

"When the syndicator refers to 'earnings' from the syndicated property, he usually means a 'cash flow' available for distribution to the investors. The cash flow is that amount by which the gross revenues from the property exceed (a) expenses of operating the property, plus (b) amortization payments required under mortgages on the property. Cash flow is not the same amount as the taxable net income from the property, because of the depreciation deduction."

In Franchard Corporation, 19/ the Commission made the same distinction in its consideration of a cash flow real estate company and its problems in relation to the requirement for full disclosure of the nature of its distribution in its prospectus. The Commission said:

"Depreciation deductions do not represent an actual cash outflow. To the extent that they (and other non-cash tax deductible items) exceed mortgage amortization payments and other non-deductible cash expenditures, the company derives tax-free cash from its operations. If this cash is distributed to stockholders, since it does not represent the tax counterpart of corporate earnings, the distribution is not taxable income to the recipients but is treated as a tax-free return of capital. These factors accounted in large measure for the relatively high rates of cash distributions which cash flow real estate securities offered until quite recently. The amount in excess of actual earnings is not a return on investment but a return of capital and in no sense to be equated to yield on investment."

18/ Report of the Special Study of Securities Markets of the Securities and Exchange Commission, Part I, p. 581.

19/ Securities Act Release No. 4710 (July 31, 1964).



securities which should have been relegated to the bottom rung of the financial plan ratio.

Most of the registrant's customers who appeared as witnesses in this proceeding and who purchased interests in the real estate syndications were unsophisticated investors and were known to be such by their salesmen. Some had never before invested in securities or had engaged in few securities transactions. With few exceptions, all relied on their registered representatives. To the average investor and even to the more sophisticated investor who has had no experience in real estate investments, the words "yield," "income," or "return" usually connote true income, a profit on his investment. 22/ The Commission commented on this aspect in its opinion in Franchard, supra:

"This crucial difference between the returns from investments in the securities of cash flow real estate companies and normal corporate dividends is sometimes misunderstood by unwary investors."

The Special Study also remarked, in respect of the "technical tax concepts" involved in real estate securities, that they "should be

22/ See Lese and Lee, Cash Flow; Misleading Connotations of Dividend Distributions, 31 Clev-Mar. L. Rev. 267, 272 (1964) where it is stated: "Three disclosure problems arise in connection with cash flow. The first and most obvious one is that of disclosing to an investor who is neither an accountant nor a lawyer that a deduction taken for tax purposes has given rise to a distribution which amounts to a return of capital."

The representations by salesmen referred to above as to anticipated "return," "income," or "yield" 20/ were usually accompanied by specific percentage figures, i.e., "10% yield," and were sometimes accompanied by the description "tax-sheltered" i.e., "10% yield, tax sheltered." But none of the prospectuses attempted to anticipate its distribution. The Rock Creek and Toledo Plaza prospectuses specifically disclaimed any such representations. Westfalls and Falls Plaza stated that distributions would be made "to the extent practicable." The Cheverly Terrace prospectus provides for distribution of "net distributable cash" which it then defines, using no figures. 21/

Manifestly, the prospectuses negate a reasonable basis in fact for the representations of yields of specific percentages or indeed, of any yield, whether or not tax sheltered. Hodgdon testified that in most instances he furnished the registered representatives with a probable cash distribution figure based upon his own investigation of each property. But Hodgdon's testimony offers only general statements relating to such matters as value, good location of the property, his consultation with experts and the amount of the mortgage money the banks were willing to offer. The record is devoid of any concrete evidence which would support the yield representations. Rather, Hodgdon's testimony appears to have been intended as a defense to the Division's charge that the real estate syndication interests purchased by registrant's clients were speculative

20/ To avoid repetition the word "yield" may be used at this point in the initial decision to represent either of the three terms.

21/ During the relevant period all distributions by the aforementioned syndications constituted a return or capital in whole or in part.

securities which should have been relegated to the bottom rung of the financial plan ratio.

Most of the registrant's customers who appeared as witnesses in this proceeding and who purchased interests in the real estate syndications were unsophisticated investors and were known to be such by their salesmen. Some had never before invested in securities or had engaged in few securities transactions. With few exceptions, all relied on their registered representatives. To the average investor and even to the more sophisticated investor who has had no experience in real estate investments, the words "yield," "income," or "return" usually connote true income, a profit on his investment. 22/ The Commission commented on this aspect in its opinion in Franchard, supra:

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clearly understood by the real estate security buyer, but often are not." 23/

It follows that the aforesaid representations of "yield" were unwarranted even if "yield" were deemed synonymous with "distribution." Moreover, the ordinary meaning of the words "yield," "income, and "return" denote a profit on investment, a taxable net income, "the counterpart of corporate earnings" and does not encompass a return of capital. Except, therefore, in the few instances where a sophisticated investor was made to understand that the yield would include a return of capital, the representations constituted misstatements.

Where so complex an investment is involved, it is the registered representative's responsibility, consistent with the obligation of full disclosure and fair dealing, to be certain that the customer is fully aware that the return on his investment will constitute a return of capital. 24/

23/ At p. 581.

24/ "To enable investors to appraise the real nature and the long run viability of those apparently generous returns (from cash flow real estate companies) a complex of circumstances must be brought to their attention lucidly and forcefully." Franchard Corporation, supra, p. 27.

Financial Planning and Other Accounts

Adam

Dr. G.Y.G. is an anesthesiologist who was 35 years of age and unmarried when she opened her account with registrant in or about August 1960. She came to Adam with a portfolio of securities listed on the NYSE and valued at slightly less than \$30,000 which she had obtained from a trust established by her parents. She also owned a fully paid \$40,000 life insurance annuity and \$7,000 in cash. She informed Adam that her income was about \$14,000 per year, that she had a dependent mother who might become disabled and that her investment objective was to acquire sufficient funds and income for ultimate retirement.

G.Y.G. had no experience as an investor in securities. She relied on Adam and followed his recommendations. Adam's note to Hodgdon furnishing a list of his discretionary accounts stated, in reference to G.Y. G.: "Account is set up in this manner due to complete lack of knowledge of investments and Financial Planning." Adam testified that G.Y.G. relied on him for recommendations.

Adam's original financial plan for G.Y.G. dated August 26, 1960, fixed a 60-30-10 ratio. It is pertinent that the 10% ratio figure for speculations was accompanied by the comment: "This figure not to be exceeded as capital once lost is difficult to regain under today's confiscatory tax rates (10% = 7500)." The finan-

cial plan recommended cashing of the \$40,000 annuity,^{25/} the immediate sale of securities valued at \$8,400 out of G.Y.G.'s portfolio and the retention of the balance of about \$21,000 in securities. The proceeds of the annuity and of the \$8,400 in securities to be sold were to be invested as follows: \$35,000 in two mutual funds^{26/} and \$5,000 in two units of a real estate syndication. The balance of the proceeds, something under \$10,000, was to be retained for future real estate syndication investments.

Shortly after the financial plan was prepared Adam ascertained that G.Y.G.'s income was nearer to \$20,000 per year than the \$14,000 amount appearing in that document. He also learned that her mother was not then a dependent although she was ill and might become the subject of G.Y.G.'s support. After discussion with Haight, Adam changed her investment ratio to 50-20-30 thereby increasing the so-called speculative area of her financial plan by 20% and decreasing the mutual fund and blue chip areas each by 10%. Adam described this modification as a change to a more aggressive investment program predicated upon the new information. But G.Y.G.'s stated objectives, her expressed desire for a substantial degree of safety in investments to assure adequate funds for her

^{25/} Prior thereto Adam had discussed G.Y.G.'s annuity with registrant's insurance specialist who advised that course of action.

^{26/} The financial plan included, among other things, a recommendation that G.Y.G. invest \$100 per month in each of the mutual funds. She followed this recommendation more or less religiously.

ultimate goal, taken together with his own admonition against increasing speculations beyond 10%, hardly justify such drastic emphasis on speculations.

On September 23, 1960 G.Y.G. paid into her account with registrant approximately \$37,000 representing the proceeds of her insurance annuity. \$5,000 of these funds were used to purchase two units of Rock Creek. Registrant's insurance specialist had stressed in his training lectures that the proceeds of cashed insurance policies or loans made on insurance policies should be invested only in mutual funds under professional management, "* * * not in whimseys. It is not speculative or venture capital." Nevertheless, Adam recommended the investment of part of the proceeds of insurance in securities other than mutual funds.

Between November 1960 and February 3, 1961, in three transactions, registrant sold out of G.Y.G.'s original portfolio over \$12,000 in securities or about \$4,000 more than the \$8,400 recommended for immediate sale in the financial plan. \$11,000 of these proceeds were used for the purchase, pursuant to Adam's recommendation, of 2,000 shares of the stock of Paragon Electrical Manufacturing Corporation, a purported private placement. Adam agrees these securities were a rank speculation. Haight states that in making this recommendation and purchase Adam failed to follow G.Y.G.'s plan. In April 1961, about \$14,000 of G.Y.G.'s original portfolio of securities was sold. Manifestly, Adam disregarded his own financial plan for G.Y.G. since about 70% of

the securities to be "held" were sold within a few months after those designated in the plan for immediate sale.^{27/} In the same month, after G.Y.G. had rejected an investment in Lord of the Flies, a motion picture production and a highly speculative security, as too risky for her, she purchased six units in the production for \$3,000 on Adam's recommendation.

G.Y.G. invested over \$16,000 in real estate syndications.^{28/} G.Y.G. did not understand Adam's explanations of the distinction between income and the return of capital, as Adam should have recognized. She was aware only that the income tax to be paid on distributions from her real estate investments would be less than the tax payable on returns realized from other types of securities. Her inability to comprehend these matters becomes material in respect of Adam's analyses of her account dated January 24, 1963 and March 17, 1964. These documents designated as "estimated income" Adam's projection of future distributions, which included the return of capital, from six real estate syndication investments. Despite reductions in the distributions from G.Y.G.'s syndication investments, Adam valued each such investment at cost. Further, the January 24, 1963 analysis showed losses in the speculative ratio area of \$4,893. But that figure

^{27/} Adam attempts to defend the April 1961 sale of 100 shares of American Smelting & Refining Co. stock through testimony relating to a telephone conversation with G.Y.G.'s father, a former employee of American Smelting, who advised that he saw no reason for a turn around in the company's poor earnings record and could not disagree with Adam's decision to sell that stock. However, this is inconsistent with Adam's retention of an additional 100 shares of the same stock in G.Y.G.'s account until January, 1962.

^{28/} This includes the purchase of one unit of Toledo Plaza from her mother for \$2,500 in 1962 on Adam's recommendation. This transaction does not appear on registrant's books.

totally ignored G.Y.G.'s total loss of her \$11,000 Paragon investment which registrant advised, in December 1962, she could write off completely for tax purposes. At the end of the analysis which showed both cost and current value of G.Y.G.'s securities at about \$61,000 without regard to the Paragon and other losses, Adam commented:

"Georgiana, you must be congratulated on the overall performance to date." In the letter accompanying his March 17, 1964 analysis which showed total cost of securities of \$65,700 and total value of \$72,000 (with Paragon loss still omitted and real estate syndications still valued at cost) Adam wrote: "Georgiana, during the next 5 to 10 years your net worth could easily amount to \$120,000 minimum * * *."

During the relevant period G.Y.G. sold over \$32,000 of the securities she owned on opening her account with registrant. She invested, pursuant to Adam's recommendations, approximately \$50,000 in securities.^{29/} Except for three minor purchases totalling about \$2,500, each security purchased by G.Y.G. was an issue of which registrant was either the underwriter, co-underwriter, member of the selling group or which the registrant sold out of its trading account, as principal. This factor takes on special significance in the light of the complete absence of any blue chip acquisitions by G.Y.G. and the fact that the commissions charged customers and earned by both registrant and the salesmen are higher on underwritings and principal transactions than on transactions in either listed or over-the-counter securities on an agency basis.

^{29/} This does not include over \$29,000 in mutual funds or \$12,500 in a gas and oil program. Adam had described gas and oil units to G.Y.G. as low risk investments.

C.A.S. is a naval officer for whom Adam prepared a financial plan on December 2, 1960. He had a portfolio of securities valued at about \$113,000, \$68,000 of which consisted of investments in two mutual funds. His original investment objective was to accumulate capital gains. The financial plan fixed a 60-30-10 ratio and stated that "Special situations and speculations should be kept to a minimum of 10% because of the large degree of risk involved." Early in 1961 C.A.S. had an indication that if he did not receive a promotion he would be required to retire. He decided that his objective should be changed and his investments directed toward the production of income.

C.A.S. had engaged in securities transactions before he came to registrant and had an account with another broker-dealer at the same time he maintained the account with registrant. Nevertheless, he was not knowledgeable or sophisticated in the securities field, could not distinguish between a principal and agency transaction and did not know the difference between a return of capital and a return based upon profits. He testified that he followed the vast majority, if not all, of Adam's recommendations and depended entirely on Adam to advise him with respect to the purchase and sale of securities. The Hearing Examiner credits his testimony.

C.A.S. invested about \$11,000 in units of Capital Properties, Inc. a real estate company. Each \$1,000 unit consisted of a \$1,000 9½% debenture and 20 shares of common stock. The issue was underwritten by registrant. Adam represented to C.A.S. that the stock attached to

the bond units would be worth more than the bonds themselves in the very near future. The prospectus indicates that the issuer allocated only \$20 of the proceeds of the sale of each unit to the payment of the 20 shares of common stock.

The Division asserts that Capital Properties was a new small company, the security was unconventional, entailed high risk and, therefore, was unseasoned and speculative. Respondents state that the security was unseasoned, that the issuer was engaged in a relatively unconventional operation and its debentures involved a higher degree of risk than would have been the case in respect of senior debt securities of larger companies. Adam testified that the 9½% interest rate on the debentures was indicative of high risk when compared with the 5% or 6% rate offered by other debentures. It is apparent that if the issuer had not been engaged in real estate activities the security would be deemed to fall within the speculative ratio area.

Upon Adam's recommendations C.A.S. purchased 880 shares of Wise Homes in four separate transactions at prices ranging downward from 23½ to 4½ between February 1961 and November 1961. Registrant acted as principal in all these transactions. In October 1961 C.A.S. purchased 200 shares of Wise Homes at 5-3/4. In November 1961 he purchased 265 additional shares at 4½. On the same day in November 1961 Adam advised G.Y.G. to sell her Wise Homes stock since he had received adverse information regarding the company. Adam's statement

that he was averaging down for C.A.S. deserves short shrift since he fails to explain why one would average down in a stock whose prospects were poor even at the lower price. Nor, for the same reason, would his explanation that it was bought so that higher cost Wise Homes shares could be sold for a tax loss, be acceptable.^{30/}

C.A.S. invested in three real estate syndications, \$3,000 in Falls Plaza, \$7,500 in Toledo Plaza and \$13,500 in Cheverly Terrace. As to each such investment Adam represented to C.A.S. that he would receive a high rate of income -- in two instances 10% -- that there was a tax shelter and that in about 5 years the property could be sold at a substantial capital gain. It is apparent from the testimony of C.A.S. regarding Adam's explanation of real estate syndication investments that he had no clear understanding that part of the income to which Adam referred would be a return of capital.

In a letter to C.A.S. dated September 18, 1962, Adam stated that all income from real estate is estimated to be tax free and non-reportable during the next several years. Further, in Adam's "Investment Summary" of May 24, 1963 which he furnished to C.A.S., Adam used cost as value in respect of C.A.S.'s real estate syndication investments without making any effort to ascertain the prices,

^{30/} All C.A.S.' Wise Homes stock was eventually sold during the relevant period, the last 465 shares at \$.05 per share. His transactions in Wise Homes stock resulted in a total loss of \$10,800.

^{31/}
if any, available at that time.

It is also relevant that the proceeds of certain C.A.S.'s life insurance policies were invested in real estate syndications rather than mutual funds, contrary to registrant's policy. Although Adam testified that C.A.S. suggested such use of the proceeds, the record is devoid of any attempt by Adam to deter C.A.S.

During the relevant period C.A.S. sold about \$50,000 of his original portfolio securities. He purchased, upon Adam's recommendations, about \$72,000 of securities and sold about \$22,000 of those. About \$44,000 of the \$50,000 in securities he retained represented new issues of which registrant was the underwriter or securities sold by registrant out of its trading account as principal. Of the \$22,000 in securities purchased and sold during the relevant period, over \$14,000 of those purchases represented securities sold by registrant as principal.

^{31/} Although registrant did not make a market in these securities, it did attempt to dispose of them where purchasers could be obtained and to that extent maintained a record of sales and purchases in each of the syndications of which it was the underwriter.

Carr

G.C.A. has known Carr over 25 years and became Carr's client in 1958. He is a general officer in the U. S. Marine Corps and an attorney.

The objectives of G.C.A.'s original financial plan were to provide an income for his wife for life and funds for the college education of his two sons. However, late in 1960 he suffered substantial business losses and changed his investment policy in an attempt to achieve greater returns to offset his losses. Although G.C.A. had investment experience prior to opening his account with registrant and decided the direction of his investments, he relied on Carr to keep him informed as to what was available in the securities market for his purpose. Prior to the relevant period he had given Carr discretionary authority over his account.

Apart from mutual funds, Carr's purchase recommendations during the relevant period reveal his inordinate concentration on securities of which registrant was the underwriter. In 20 separate purchase transactions by G.C.A. amounting to over \$33,500, only four purchases totalling about \$4,000 represented securities not underwritten by registrant.

H.C.F. opened an account with registrant through Carr in the fall of 1961. He was an officer in the armed forces stationed in Korea and had been recommended to Carr by a brother officer. Until the late summer or fall of 1962, when he returned to the United States,

all his communications with Carr were through the mails.

Between October 1961 and March 1962 Carr sold ten of H.C.F.'s original portfolio securities for about \$7,700. In that period Carr invested \$1,000 in a mutual fund, \$1,000 in a real estate investment trust and about \$4,700 in five speculative securities. Except for the \$1,000 mutual fund investment and one security purchased for \$850, every acquisition by Carr for H.C.F.'s account was a security of a new issue of which registrant was the underwriter.

Kibler

D.B.S. has been a widow since 1947. She was 70 years old when she testified in 1966. She had her first transaction with Kibler in August 1962 when she telephoned him to purchase a security. Thereafter, in October 1962, she conferred with Kibler regarding financial planning after furnishing him a financial planning worksheet.

D.B.S. had no dependents, no one to whom she desired to leave her estate, a portfolio consisting largely of seasoned, listed securities having a value of over \$35,000 and an annual income from securities of about \$1700 - \$1900. Her investment objective was to obtain a larger income and safety. A summary of the conference, prepared by Kibler on October 30, 1962, reflected the objectives of D.B.S. to include "increase quality of portfolio through elimination of weaker issues" and "increase dividend income."

Here, the client's objective for "increase(d) dividend income" was achieved through the initiation of a systematic withdrawal plan from her mutual fund investment, clearly a return of capital, and from distributions from her real estate investments, similarly a return of capital in large part. But D.B.S. testified that she understood that her mutual fund shares would be reduced by her withdrawals. Although she could not define the difference between a return based on profits

and a return of capital, she testified she understood when Kibler represented to her that Richmond Motor Lodge Associates ("Richmond") and Castaway Motor Lodge ("Castaway")^{32/} would yield between 7% and 9%, tax sheltered and First National Real Estate Trust ("FNR") would pay between 7% and 9%, that some of these monies included a return of capital.

D.B.S.' testimony in this respect was surrounded with an atmosphere of uncertainty. Nevertheless it agrees with and supports Kibler's purpose to acquire more "spendable dollars" for D.B.S.^{33/} without regard to true income.

But the foregoing in no way detracts from the implications to be drawn from the fact that during the relevant period D.B.S. sold about \$25,000 of the securities she owned when she came to Kibler. She purchased over \$30,400 in securities, upon Kibler's recommendations, of which sum almost \$30,000 represented new issues of which registrant was the underwriter and securities sold out of registrant's trading account, as principal.

32/ Both real estate limited partnership syndications.

33/ "Q. 'And is my understanding correct that your prime objective when you went to Mr. Kibler was to get more spendable dollars from the securities you had in your portfolio?

A. Yes sir."

Kibler acquired K.F.J. as a client through a cold call.

He obtained a financial planning worksheet from K.F.J. and held at least two meetings with him, one attended by his wife. K.F.J.'s objective was to achieve the best possible return for his retirement.

K.F.J. and his wife earned about \$16,000 annually. He had \$6,800 in cash, \$7,000 in Government bonds and a portfolio valued at about \$18,000, of which about \$15,000 represented securities listed on the NYSE. The financial plan prepared by Kibler on April 5, 1962 recommended investment of 31% of K.F.J.'s investment capital in mutual funds, "17% in federally regulated real estate trust shares," 32% in blue chips and 20% in "special situations," here synonymous with speculations. However, after the last meeting with K.F.J. and his wife, Kibler concluded that the 20% figure for speculations was too extreme for his clients and reduced it to 10%.

K.F.J. was not a sophisticated investor. He had dealt with one broker-dealer prior to registrant. He did not know the difference between an agency and a principal transaction. He could not distinguish between a return of capital and a return based on profits. He "struggled mightily" with prospectuses but, apparently, in vain. He followed Kibler's recommendations.

Kibler represented to K.F.J. in respect of his purchase of Westfalls that he could expect something between a 7% and 9% return; in respect of Richmond, that there would be a return of 7% to 9% which would be tax sheltered; in respect of Kent-Washington, a corporation engaged in real estate activities, in substance, that it

provided a tax sheltered income.

During the relevant period all K.F.J.'s original portfolio securities were sold, and he made purchases of securities totalling about \$33,700^{34/} pursuant to Kibler's recommendations. Between May 1962, when he opened his account with registrant, and September 1963, K.F.J.'s purchases totalled \$25,500. Every security was either a new issue of which registrant was the underwriter or a security sold by registrant out of its trading account as principal. On April 29, 1964 K.F.J. purchased four blue chip securities for a total of about \$8,200.

^{34/} Including about \$10,000 in mutual funds.

Kitain

D.G.Y. is a housewife who met Kitain when both Kitain and her husband were in the foreign service. They had a number of discussions during which Kitain learned that D.G.Y. and her husband owned property in Vermont which they wished to develop into a resort. She told Kitain that she had inherited a portfolio of securities, was interested in a program which offered liquidity and would be sensitive to their needs in developing the Vermont resort.

Kitain agrees he was informed that D.G.Y. had no experience in the securities field, knew very little about stocks and found things difficult when she was overseas with her husband on his assignments. Kitain also agrees that D.G.Y. accepted all his recommendations.

D.G.Y. furnished Kitain with a list of her securities consisting largely, if not entirely, of high grade listed stocks.^{35/} Kitain analyzed the portfolio, determined that some of the securities were "doubtful" and that the problem of the management of her investments could best be solved by putting the bulk of them into mutual funds. He split the securities into three groups -- those for immediate liquidation amounting to about \$30,000 in value, those for sale in the medium future and those to be held.

^{35/} The Division values the portfolio at \$90,000 to \$100,000 to which respondents do not object.

Kitain presented a plan to D.G.Y. whereby the proceeds of the stocks for immediate liquidation would be utilized to accomplish the following:

- 1) Invest \$25,000 in the Aberdeen Fund, a mutual fund. ^{36/}

Since \$25,000 was above the "breakpoint", D.G.Y. would be entitled to a reduction of 1% of the cost of the purchase.

- 2) Invest \$5,000 in the Putnam Growth Mutual Fund, at the same time signing a letter of intent to increase her investment above the breakpoint thus entitling her to a 1% reduction in the cost of the Putnam purchase.

- 3) Withdraw 90% of the Aberdeen investment and invest the proceeds of the withdrawal in Putnam.

- 4) Sell part of the securities in the medium range future category within one year and replace the withdrawal from Aberdeen to maintain her right to the reduced cost of the Aberdeen investment.

Steps 1 through 3 were accomplished. Registrant realized commissions of 6% on the initial \$25,000 Aberdeen investment, the \$5,000 Putnam investment and the \$20,000 Putnam investment resulting from the withdrawal from Aberdeen. ^{37/} Kitain's commissions on these transactions amounted to about \$1,500.

^{36/} Hodgdon had an indirect interest in Aberdeen Fund which was one of the mutual funds recommended consistently by registrant's salesmen.

^{37/} D.G.Y. became disenchanted with mutual funds and did not replace the withdrawal from Aberdeen.

The sale of D.G.Y.'s securities to enter into the mutual funds transactions resulted in capital gains of about \$15,000 and a capital gains tax of about \$3,500.^{38/} The consternation this unanticipated tax caused D.G.Y. raises considerable doubt that she would have consented to go forward with the sale of her securities had Kitain not agreed that the resulting capital gains tax could be offset. Moreover, registrant had a firm policy against switching mutual funds. Although Kitain protests that the policy did not apply to this situation, it is significant that he did not advise registrant's management of the transactions.

In June 1961 Kitain purchased for D.G.Y. 4 units of Toledo Plaza for \$10,000. Since this security was not readily marketable,^{39/}

^{38/} D.G.Y. attempted to offset these capital gains against certain expenses connected with the construction program of the Vermont resort. She had indicated her intent to do so to Kitain when they first considered the sale of her portfolio securities and anticipated that capital gains would be realized. Kitain agreed that such a course would be appropriate. He was not a tax expert and should not have approved or agreed to it. Internal Revenue disallowed the offset. The fact that an accountant prepared the client's tax return does not excuse Kitain on whom D.G.Y. relied.

^{39/} The cover page of the Toledo Plaza prospectus stated there was no market for the units and it is probable that the only market would be through registrant or its co-underwriter. The prospectuses of all the syndications mentioned above contain statements indicating that the units were not readily marketable.

its purchase was contrary to D.G.Y.'s objective of liquidity.
D.G.Y. testified Kitain told her, in a telephone conversation,^{40/} that Toledo Plaza had a guaranteed 10% income which was tax sheltered and although not as liquid as stocks, would nevertheless be marketable. Kitain also recommended that D.G.Y. borrow the funds with which to purchase the units. He had advised her, earlier, that a loan would cost 6% and with it she could acquire an investment producing a 10% income thus profiting to the extent of 4%.

Kitain denies that he told D.G.Y. that Toledo had a guaranteed income of 10%. He asserts he said that the real estate syndication would have cash flow and tax shelter in excess of the amount she would pay as interest on her loan. D.G.Y.'s testimony is credited. However, even if Kitain's testimony were accepted, his comparison of interest on a loan with a return of capital was unjustified. "Spendable dollars" was not this client's objective.

Between February 17, 1961 and February 24, 1961 D.G.Y. sold over \$36,000 of her original portfolio securities.

A.H.R., a foreign service officer, has been Kitain's close friend since 1952. He became Kitain's client in 1959.

Although he furnished Kitain with the usual financial planning worksheet, Kitain did not indicate a ratio of investments to be

^{40/} In May 1961 D.G.Y. and her husband were stationed in Quebec. She gave Kitain written discretionary authority to act for her in securities transactions.

followed. A.H.R.'s testimony discloses that he made his own investment decisions or made them jointly with Kitain. He found it difficult to determine at which point he was taking Kitain's advice. He rejected Kitain's constant recommendations for greater investments in mutual funds, preferring to choose his own time.

In his original discussion with Kitain he indicated his desire to plan for the education of his three small children and for his retirement. He displayed an interest in absolutely safe growth stocks and blue chips. But he had had some success with the stock of Jonkers Business Machine, a speculative security, and was eager for similar opportunities. He noted that the original backers of Jonkers had made a much greater profit than those who came in later, presumably on the public offering.

Registrant's insurance specialist recommended to A.H.R. that certain of his life insurance policies be converted to achieve reduced premiums and the release of cash surrender value for investment purposes, without reducing coverage. It was also suggested that A.H.R. might borrow against his insurance and that, in accordance with registrant's policy, A.H.R. invest the proceeds of such conversion or borrowing in mutual funds. Although A.H.R. did not take the steps recommended by the specialist in respect of his insurance, he did convert one policy which made available about \$2,000 and borrowed about \$3,000 on a second policy. Kitain was fully aware of the

source of these funds and admits that he made recommendations for their use which A.H.R. followed and which included the purchase of two securities which were unseasoned and speculative.

On six occasions through May 1962 Kitain used A.H.R.'s account for his personal purchases of securities. The first four purchases were made together by Kitain and A.H.R. each owning one-half the number of shares charged to A.H.R.'s account. The last two purchases were exclusively Kitain's. A.H.R.'s account was used for these transactions with his knowledge and consent. He testified that Kitain told him he used A.H.R.'s account because Hodgdon objected to the purchase of certain securities by salesmen or because the Commission would not approve. Kitain testified that Hodgdon specifically prohibited salesmen from purchasing one security of which registrant was part of the selling group and rejected Kitain's personal request to be excepted. In his prehearing testimony on July 14, 1965, Kitain admitted there was a prohibition by registrant against the use of customers' accounts, as nominee, by salesmen. The Hearing Examiner accepts this testimony over Kitain's testimony at the hearing that he cannot recall any specific written or oral statement on the subject.

A.H.R. went overseas in June 1962 and gave Kitain written discretionary authority over his account. In December 1962 Kitain purchased 100 shares of Van Pak. The transaction appeared in A.H.R.'s account. Upon receiving his statement from registrant, A.H.R. protested

vigorously against the purchase of that security. In response, Kitain advised him that the purchase was not for A.H.R.'s account, that Kitain had to execute a sale for another customer to establish a tax loss and had utilized A.H.R.'s account rather than his own because he "was suffering from a case of the 'shorts'."

At the end of 1959 A.L.A. was recommended to Kitain by A.H.R., her son-in-law. She met with Kitain in December 1959 and again, together with her husband, in January 1960. She advised Kitain that she had a married dependent son who had a family, that she wanted to maintain her income at its current level (of about \$5,000) or, if possible, to realize a little more, and that she was interested in growth. Although A.L.A.'s financial planning worksheet offered little information, she told Kitain that her financial resources consisted of about \$76,000 in a trust fund, \$50,000 in savings and loan institutions, \$10,000 in Government bonds and about \$28,000 in securities. Although virtually all the securities were listed and high grade, Kitain assured her that he could do better and would invest in such a way as to give her a better income, growth and safety.

Kitain established a financial planning ratio of 50% - 30% - 20%. After learning more about A.L.A. he reduced the latter figure to 10%. A.L.A.'s first transaction with Kitain was in mutual funds. Kitain recommended the investment of a larger sum but A.L.A., who "was not too enthused about mutual funds," agreed to invest \$15,000 in Aberdeen. On Kitain's recommendation A.L.A. instituted a plan pursuant to which she withdrew \$125 every three months from her Aberdeen investment.

A.L.A. testified Kitain stated to her that the interest and dividends to be reinvested in her Aberdeen accounts would cover the amount of her withdrawals. It is evident from the difficulty Kitain displayed in answering questions which attempted to establish whether he advised A.L.A. that at least part of her withdrawal from Aberdeen would constitute a return of capital, that he failed to do so. This conclusion is supported by A.L.A.'s cancellation of the withdrawals when she realized that she was using her principal.

Pursuant to Kitain's recommendations A.L.A. invested \$10,000 in Rock Creek, \$5,000 in Toledo Plaza and \$10,000 in the 6½% cumulative convertible preferred stock of Apache Realty Corp. Registrant was part of the Apache selling group. Apache was a real estate company which had been organized less than a year before the public offering. Respondents agree that after deduction of depreciation and other expenses, Apache would have no earnings and that dividends paid on the preferred stock would constitute a return of capital.

In recommending the real estate syndications to A.L.A., Kitain told her that the units were not readily marketable and that she would have to hold them for about eight years. She also testified that Kitain represented to her that Rock Creek would give her a tax sheltered income of 8%. Kitain testified he told her Rock Creek would return from 7% to 9%. A.L.A. received the prospectus and read it but relied mostly on what Kitain said. On purchasing Toledo Plaza, A.L.A. testified Kitain told her it was a better investment than

Rock Creek since it would yield 9%, was tax sheltered^{41/} and safe.

Kitain testified that he fully explained return of capital distributions to A.L.A. at their first meeting and again when she purchased Rock Creek. But that explanation, quoted below,^{42/} offers little in furtherance of Kitain's position. It says, in effect, that it's better to receive the return of your own capital, tax free, than to realize a taxable profit. That on cross-examination A.L.A. could not say that the words "income" or "yield" were used, does not aid Kitain where the matter is so complex that even sophisticated investors are unable to fully comprehend the intricacies of such investments. And even if Kitain had properly advised A.L.A. that all or part of the Rock Creek and Toledo distributions would include a return of capital, it is impossible to reconcile these recommendations

^{41/} Her testimony demonstrates her confused understanding of "tax shelter":

"It was a tax sheltered income and after this was diminished the owner as a rule would sell the building and then I would get my money plus whatever it would sell for back."

"It was explained to me. I could not explain it to you, but every year, instead of an interest payment I would have a certain amount of deductions from my income tax."

^{42/} Here Kitain testified he explained to A.L.A. that "from the point of view of an investor, a tax free at the time of payment return would be a better return than the same number of dollars if they came as fully taxable income."

with A.L.A.'s income objective, especially since A.L.A. made withdrawals from her savings and loan accounts to acquire these syndications and Apache Realty, thus sacrificing true income.

In inducing A.L.A. to purchase the stock of Wise Homes, Kitain told her that it was better than Jim Walters, another company in the shell home industry, the price of whose stock had risen substantially. A.L.A. also testified, and Kitain does not deny, that when the price of the Wise Homes stock went down and A.L.A. called Kitain to inquire what was wrong, he replied that they wanted the stock to go down because they wanted to put all their people into this stock.

Between April and November 1960 A.L.A. sold about \$11,500 of her original portfolio securities. From April 1960 through November 1961 A.L.A. purchased about \$34,500^{43/} in securities other than mutual funds. It is pertinent that of this total about \$28,800 or over 83% represented the purchase of new issues in which registrant was the underwriter or part of the selling group or securities sold by registrant out of its trading account as principal.

^{43/} This includes four securities which A.L.A. purchased for a total of \$1,750 and sold.

Haight

F.E.T. is an unmarried woman who was about 67 years of age in 1960. During a meeting with F.E.T. in July or August 1960 Haight learned that she had no dependents, she was employed by the Navy at a salary of about \$8700, was due for retirement, uncertain of her income and desired to increase it. She owned \$2500 in U. S. Government bonds, \$18,000 in savings and loan deposits and a portfolio of securities valued at about \$61,000. With the exception of a mutual fund stock and one unlisted stock, all E.E.T.'s securities were listed on the NYSE and virtually all were dividend paying.

Undoubtedly F.E.T. was an experienced investor having been active in the securities field since the 1920's. It is also plain, however, that she considered Haight trustworthy, believed she could rely on him and placed substantial weight on his recommendations. She named him co-trustee of two charitable trusts she created at his suggestion.

Those securities sold from her original portfolio were sold either upon her own choice or upon Haight's recommendation with her considered agreement. The areas for concern, however, are the purchases rather than the sales. It has been stipulated that all purchases in F.E.T.'s account were made pursuant to Haight's recommendations.

F.E.T.'s account, under Haight's guidance, must be considered in the light of Haight's financial plan for F.E.T. dated August

1960 in which he established a ratio of 50% in mutual funds, 35% in blue chip, real estate and individual securities and 15% in speculations. The plan included a chart representing F.E.T.'s "completed investment program after adoption of present and future recommendations" in which the 35% or middle bracket is presented as including investments in electronics, utilities, chemicals, real estate and gas and oil.

In persuading F.E.T. to purchase real estate syndications Haight admittedly represented to her that he hoped for returns of about 7% to 9% from Rock Creek and that Cheverly Terrace could return 7% to 9%.

At the end of the relevant period F.E.T. had securities which were purchased for a total of about \$53,000.^{44/} An additional amount of \$7,100 in securities, mostly "wild speculations," were purchased during the relevant period and sold to establish tax losses. All but about \$700 of the \$60,000 total represented purchases of new issues of which registrant was underwriter or sales by registrant out of its trading account as principal. In view of F.E.T.'s objective to increase her income, it should be noted that \$44,000 were invested in real estate securities, the distributions from all of which consisted in whole or substantially part of a return of capital and about \$10,000 in speculations. Moreover, F.E.T.'s purchases include none of the

^{44/} Exclusive of \$12,000 invested in Aberdeen.

investments in electronics, utilities or chemicals referred to in Haight's financial plan for F.E.T.

G.M.B. had her first meeting with Haight at her home in the fall of 1962. She was interested in the Richmond real estate syndication and purchased 10 units for a total of \$10,000 at that meeting. Haight told her that, hopefully, Richmond would return about 13%.

Although urged to do so, G.M.B. did not furnish Haight information regarding her resources until about March of 1963 when she informed him that she had a portfolio of substantial, high quality securities valued at \$36,500 together with \$45,000 in U. S. Treasury notes and industrial bonds amounting to \$21,000. One of G.M.B.'s principal objectives was to increase her income from investments.

In March 1963 Haight prepared a financial plan for G.M.B. which established a ratio of 50% - 40% - 10%. The plan noted that her income from investments for 1962 had been \$3100. In early April 1963, at a meeting with G.M.B. Haight varied the ratio to 30% - 40% in mutual funds, 30% in blue chip securities and 30% in "real estate."

Prior thereto and in March 1963,^{45/} at Haight's recommendation, G.M.B. purchased 1 unit of Falls Plaza for \$1050, 2 units of Cheverly Terrace for \$5670 and 1 unit of Toledo Plaza for \$2500, all resales

^{45/} G.M.B.'s account reflects no transactions between her Richmond purchase in October 1962 and the transactions here related in March 1963.

by other investors. In each instance the purchase price included a mark-up of 5% on the buyer's side and a mark-down of 5% on the seller's side, thus affording registrant a commission of 10%, of which Haight received half. Although the Toledo Plaza purchase price was the same as the original offering price, it, nevertheless, included the mark-up because of a reduction in its value due to storm damage to the property. Haight stated at the hearing that he told G.M.B. of the mark-ups. But his earlier testimony during the Commission's investigation of the case negates this testimony.

Haight testified that he told G.M.B. that he expected a distribution of about 7% from Falls Plaza, all not reportable, and that he expected a distribution of 7 - 9%, tax sheltered, from Cheverly Terrace. Respondent's brief admits that during the conversations attendant the Richmond purchase in October 1962, there is uncertainty whether Haight used the word "distribution" or "income" or "return". But regardless of which word he actually used, the conclusion is inescapable that at that time of the aforesaid purchases G.M.B. did not understand that the distributions from these syndications were not true income.

It is asserted that because G.M.B. had invested in real estate earlier, had rented all or part of her home from time to time and was aware of a depreciation factor in that connection, Haight's reference to "income" and "return" would not have been misleading. But the substance of G.M.B.'s testimony regarding tax benefits related to the renting of her home appears to be limited,

principally, to deductions for expenses incurred in operating the property. Haight also testified that, having explained the meaning of a distribution to G.M.B. at least twice, he used the word "income" or "return" satisfied that she understood he was referring to "distribution". However, G.M.B.'s testimony discloses that at the time of the Richmond purchase she was unable to distinguish between a return of capital and a return based on profits. Moreover, she first became aware that "tax shelter" was in some way related to depreciation in preparing her tax return after she had purchased real estate units, other than the first Richmond purchase. (She made four such purchases in 1963.) She then asked Haight about it and he explained it to her. This is consistent with Haight's testimony that G.M.B. complained about "having to fill out the forms," and indicated confusion as to the difference between the amount of a distribution that would be taxable and that "which would be offsetable as a net tax loss."

In a report to G.M.B. dated October 1963, Haight estimated \$5155 as G.M.B.'s "income from investments during 1964." Haight knew that the income of \$3,100 on investments referred to in G.M.B.'s financial plan represented true income. It is clear that Haight's estimated increase in "income" would consist of distributions which were largely return of capital. Haight's notes disclose that on November 18, 1963, not more than one month after his \$5155 income prediction for 1964, he "told her I expected her income to be in excess

of \$7,000 the next year."^{46/}

The proceeds of over \$52,000 of G.M.B.'s securities sold during the relevant period were used to purchase about \$64,000 in securities.^{47/} \$58,000 thereof represented new issues of which registrant was underwriter or securities sold to G.M.B. as principal out of registrant's trading account and of the latter figure \$47,500 represented purchases of real estate securities.

^{46/} At this time G.M.B.'s account included only mutual funds and real estate securities in addition to some of the securities she owned on opening her account with registrant.

^{47/} Excluding a \$10,000 investment in Aberdeen.

Harper

C.J.M. met Harper through a real estate broker in 1961 while she was seeking to purchase real property as an investment. Both she and her husband had been born in Germany and had come to the United States in 1952. Her income in 1961 was \$3,000 to \$4,000. Her husband had just started a new business and drew from it \$80 to \$100 a week. C.J.M.'s resources consisted of about \$20,000 in savings and loan accounts, real estate in Florida valued at about \$5,000, \$1,100 in mutual funds and a second trust note in the amount of \$5,000.

C.J.M.'s objective, stated to Harper, was to improve her retirement income through profitable investment, to achieve a high return on her investment and growth. She also indicated, as she did many times thereafter, that she needed to keep a certain liquidity for emergencies in her husband's business and in the lives of her mother and mother-in-law both of whom were dependent on her and her husband.

She advised Harper that she had no experience in the securities field. Indeed, her only previous securities transaction was the \$1,100 investment in mutual funds. Harper assured C.J.M. that "they" were counsellors, their specialty was financial planning for people who wanted to increase their returns that that she should "consider him like my doctor * * * to kind of diagnose my financial potentials and possibilities." She testified that she reacted with confidence. Although she occasionally failed to follow Harper's recommendation because, infrequently, she "had some

hesitation" about it or didn't have the funds or had other plans for the funds, the record is abundantly clear that C.J.M. and her husband both relied on Harper as their financial counsellor, as he had urged them to do.

C.J.M. was discouraged by her single experience with mutual funds and rejected Harper's early recommendations in that direction although she did invest in mutual funds later. Her first purchase was a unit of Toledo Plaza for \$2,500. She testified Harper represented to her that it probably would yield 9%, that she would benefit from depreciation and amortization, that she could rely on a high yield and also on appreciation in value after about a decade. C.J.M. asked if she could sell the unit on short notice and Harper replied that she might be able to sell it within 24 hours -- there was always that possibility. When C.J.M. purchased one unit of Cheverly Terrace for \$2,700 Harper told her that it was similar to Toledo Plaza, a high yield of 9% and that she would benefit from any appreciation when the property was sold later -- perhaps in ten years. Of Westfalls, in which C.J.M. invested \$1,000, Harper said there would be a good yield -- she doesn't remember the percentage. She invested \$1,000 in the Richmond. Harper said it would pay a high return of 11%. C.J.M. does not recall whether Harper used the word "dividend," "return" or "yield."

Harper offered no denial of C.J.M.'s testimony as to the yield she might expect on these investments.

It is also relevant that in recommending that C.J.M. invest in Lord of the Flies, Harper represented to her that she probably could double her money within two or three years. Harper succeeded in causing C.J.M. to make this purchase only after telephoning her several times because she felt insecure about it.

A review of C.J.M.'s account with registrant discloses that out of total purchases of approximately \$27,700^{48/} about \$21,000 were purchases of either real estate syndications or real estate corporations pursuant to Harper's recommendation. With the exception of one such purchase in the amount of \$862.00 which came out of registrant's trading account, every real estate security was a new issue in which registrant was the underwriter. Further, of the \$27,700 total, all but about \$1,150 represented either new issues of which registrant was the underwriter or securities transactions in which registrant acted as principal.

A.K.D. was a retired social worker. She was divorced and had one dependent son who was Harper's friend. She lived in Frederick, Maryland where Harper also resided. Early in 1961 Harper asked to look over her portfolio. She acquiesced and Harper prepared a list of her securities. They consisted of high quality stocks of banks, utilities, railroads, and some of the largest industrial enterprises in the country together with a small amount of bonds. The portfolio had been acquired

^{48/} About \$2,000 of such purchases were sold during the relevant period.

through inheritance and gifts from A.K.D.'s parents and had a value of about \$200,000.

In addition to the income from her securities, A.K.D. received alimony payments amounting to \$2,400 per year. She was fearful, however, that these payments would stop. Her investment objective, therefore, included increased income. Further, as she expressed herself to Harper many times both orally and in correspondence, she insisted on safety in her investments. Harper was aware that A.K.D. had no previous experience in the securities field, and was an entirely unsophisticated investor.

During their initial conversation Harper assured her that she would have expert advice, that she would not have to be concerned about securities -- he would do that for her -- and that "they" specialize in estate planning. At a later conversation in August 1961, she made it plain to Harper she would have to rely on his advice to which he responded that she let him do the worrying. During her testimony she said: "What he recommended, I bought."

On August 23, 1961, A.K.D. wrote Harper saying that it frightens me "to turn over such a large amount of money." She insisted, "It's a must that I play it safe. * * * I just must safeguard all I have." The letter resulted from her conversation with Harper in which he offered a plan involving the sale of 25 to 35 of her portfolio stocks which Harper said were low yields, overly priced and that she should move into something less risky. Harper's response of August 25, 1961 is replete

with reassurance. He sees nothing in her portfolio but "safe-guards." He is pleased that she "could see the need of acting" and "understands." He can assure her of \$1,000,000 if she were willing to take risks but "we are now keeping you comfortable and moving toward the \$500,000 -- \$750,000 level." He urges her to stop worrying. He has reduced the period of rearrangement of her portfolio from seven years to three years putting them ahead of schedule. "You are 50% better off today than you were Sunday."

By August 23, 1961, the date of A.K.D.'s letter described above, Harper had already sold about \$25,000 of her securities and she had purchased an approximately equal amount of securities with the proceeds. With the exception of \$500 invested in Lord of the Flies, all the purchases represented real estate syndications or real estate stocks, all were new issues and in all but one instance, registrant was the underwriter. In the single exception registrant was a member of the selling group.

A.K.D. testified Harper urged her to go along with the plan and believe in it. She was "scared" but accepted it. The plan, as it was presented in writing on October 5, 1961, presented a ratio of 50% high grade, 30% special situation and 20% speculation. But high grade, in this plan, in addition to \$20,000 A.K.D. had already invested in Aberdeen, included the real estate syndications she had purchased and an \$8,200 investment in Capital Properties. "Special situations" included all of A.K.D.'s as yet unsold high quality original portfolio securities

and the "speculation" area included a unit of Apache Canadian Gas and Oil Program 1961 purchased for \$5,000. Among the type of securities the plan purports to consider for future purchase are "reasonably priced utilities," "reasonably priced consumer products companies," "reasonably priced bank stocks" and "reasonably priced insurance stocks."

An examination of the transactions in A.K.D.'s account readily establishes that Harper could not have had any intention of carrying out the plan he presented. Thus, through January 1964 when the account ends, A.K.D. realized from Harper's sale of her original portfolio about \$122,000 and purchased about \$89,000 in securities.^{49/} The account includes no utilities, no bank stocks, one consumer product stock purchased in January 1964 for \$3,800, and two purchases of the same insurance company stock for about \$3,800, one a new issue of which registrant was the underwriter and the second a principal transaction.

Further, out of a total of about \$103,000 in securities acquired by A.K.D.,^{50/} Harper purchased for her about \$72,500 in real estate syndications and real estate stocks. Out of that \$103,000 total, every such security but one for \$3,800 represented a new issue in which registrant was either the underwriter or a member of the selling group or represented a transaction in which registrant acted as principal.

^{49/} This figure does not include the \$20,000 investment in Aberdeen or the Apache oil program purchase which, with assessments, amounted to about \$14,500. These did not pass through registrant's books.

^{50/} Excluding Aberdeen, but including the Apache oil program.

Other aspects of Harper's administration of this account require attention. Without regard to A.K.D.'s demonstrated fear and her pleas for safety in her investments, Harper put her into the Apache oil program, the highest type of speculation.^{51/} Harper explains this investment by pointing to the substantial tax deductions it offers to offset about \$31,000 in capital gains, which he had anticipated, resulting from the sale of A.K.D.'s original portfolio securities. But his reason for the purchase does not warrant the risk of complete loss involved in this type of security for a client whose objectives were fraught with demands for safe investments.

Harper's various reports to A.K.D. regarding the status of her account furnish clear evidence of lulling misrepresentations in respect of her objective for increased income. His report to A.K.D. of February 8, 1962 included the following yields:^{52/}

Falls Plaza	9%
Glenn Ross	8.9%
Toledo Plaza	10%
Capital Properties	4.75%
First Nat'l. R.	8%
Kent Washington	6% ^{53/}

^{51/} Haight agreed that A.K.D.'s investment in an oil program was "an error of judgment" on Harper's part.

^{52/} His plan of October 5, 1961 contained similar "yields."

^{53/} The Glenn Ross prospectus, dated March 31, 1961, anticipates distribution to the extent practicable. Kent Washington is admittedly a speculative security and the Capital Properties debenture, as shown above, was a high risk security.

As previously shown, the real estate syndications distribution were either all or in part returns of capital as were the distributions of the other securities set forth above. A.K.D. did not know the difference between a return of capital and a return based on profits. Her attitude toward returns of capital is demonstrated by the results of Harper's suggestion that she commence periodic withdrawals of \$200 per month from her Aberdeen investment in July 1963. When she realized that her withdrawals resulted in depletion of the amount of her shares, she promptly cancelled the withdrawals.

Harper's letter of September 28, 1962 responded to A.K.D.'s letter of September 27, 1962, indicating disappointment that her total gain in income (even as defined by Harper) for the first nine months of 1962 was only \$168.27 over that for the same period of 1961. In addition to telling A.K.D. she is much better off than \$168.27 because of tax freedom and other reasons, he states "I still stand by our projection of a \$15,000 to \$18,000 income by 1964." Similarly, his letter of January 30, 1963 to A.K.D. which is a "memorandum of tax protected items" refers to the real estate syndications investments as "most of income tax protected" or "mostly tax free."

Harper did not advise A.K.D. whose investment capital exceeded \$100,000 to seek the assistance of a professional investment adviser in accordance with registrant's policy. Further, Harper's insistence that A.K.D. advise him of the substance of her testimony before the Commission during its investigation does him little credit.^{54/}

Dr. C.E.B. had known Harper since the latter was 8 or 9 years old. Harper and C.E.B.'s son were friends. Harper considered C.E.B.'s home as "his second home."

At Harper's suggestion C.E.B. opened an account with registrant early in 1961.^{55/} During the conversations that occurred at that time, C.E.B. informed Harper that his financial objectives were to set up an estate, for income purposes and for retirement. He owned a portfolio of securities which he had bought "years ago" and which eventually brought about \$19,000 when sold between 1962 and 1964, but did not advise Harper of the portfolio until sometime in 1962.

^{54/} Respondent/s' proposed findings of fact contain the following footnote:

"Following her testimony in this case, Mrs. Daffin instituted suit in the United States District Court for the District of Maryland seeking \$500,000 in compensatory damages and an additional \$500,000 in exemplary damages (Civil Action File No. 17789). Thereafter defendants offered to repurchase all securities retained by Mrs. Daffin (including the oil program and all real estate limited partnership units) at the price she had paid for them, the offer was accepted and the suit was dismissed. Since such repayments may be deemed relevant as matters of public interest (Cf. Tr. 7756), respondents request the Division to stipulate to and/or concede the facts stated herein."

^{55/} Although accounts were opened both in C.E.B.'s name and jointly with his wife, they will be treated as one account.

C.E.B. was an inexperienced and unsophisticated investor. He placed complete reliance on Harper who agrees that virtually all C.E.B.'s purchases were made on his recommendation. During an illness C.E.B. gave Harper written discretionary authority over his account. Harper is named as co-executor in C.E.B.'s will.

Harper prepared a financial plan for C.E.B. similar in its categories to that prepared for A.K.D. Harper's reports to C.E.B. present his concept of the ideal portfolio, i.e., "High Grade," 50%; "Special Situations," 30%; and "Speculation" 20%. An examination of the first progress report dated August 3, 1962, and the last progress report in evidence dated February 24, 1964, indicate Harper's failure to adhere to his plan for C.E.B. The August 3, 1962 report states that C.E.B.'s account presently has this appearance: High Grade 46%, Special Situations 42% and Speculation 11%. By February 24, 1964 Harper's report shows a drastic drop in the high grade category to 15% and an increase in the special situation category to 81% with speculations at 4%. 56/ It is also pertinent that the February 1964 report shows special situation stocks at a cost of about \$37,000 and a value of over \$78,000. But \$34,000 of that increase in value is represented by estimates of the value of C.E.B.'s three oil programs. As shown elsewhere in this decision, the \$30,000 estimated value of the Apache Canadian 1961 oil program had no reasonable basis in fact. 57/

56/ These figures are based on current value. If cost were used it would reflect high grade 23%, special situations 58% and speculations 12%.

57/ No evidence was introduced as to Apache's 1962 and 1963 programs which C.E.B. purchased.

C.E.B.'s purchases included units of real estate syndications and a number of real estate stocks. Although he received prospectuses, he found them hard to digest and relied on Harper. The latter's report of August 3, 1962 presents a "yield" of 10% each for Cheverly Terrace, Toledo Plaza and Westfalls and 9.5% for Falls Plaza. Harper's report of February 24, 1964 continued the 10% "yield" figure for Toledo Plaza and Cheverly Terrace but reduced Falls Plaza to 7% and Westfalls to 9%. 58/ The actual distributions for Toledo Plaza during the relevant period reached 10% only for 1962 and fell woefully short for the other three years. Cheverly Terrace's distribution never reached 10% and Westfalls never reached 9%. Harper must have known or should have known the actual figures. As an owner of real property, C.E.B. apparently had some understanding of the meaning of "return of capital." Whatever relevance this might have to his original purchase of the syndications, it cannot cure the misrepresentations presented by Harper's reports.

The record also discloses that between mid-December 1963 and early February 1964, Harper allowed C.E.B. to sell three mutual funds securities despite registrant's rigid policy against it. The reason offered is that C.E.B. needed money and, indeed, at that time another substantial sale was made. But this is not consistent with a purchase on December 20, 1963 of \$1,000 of the stock of Southeast Mortgage Investment Trust, a new issue underwritten by registrant.

58/ In this report Harper designates dollar amounts as "income" and the percentage which those amounts bear to the amount of the investments as "yield".

During the relevant period Harper made over 50 purchases of securities, all of which were sold within that time. The great majority of these purchases were resold within about one month, some in a matter of days. Harper's testimony that C.E.B. wanted to take several thousand dollars to use for purposes of speculation satisfactorily explains these activities. However, out of \$36,500 in purchases of securities remaining in C.E.B.'s portfolio at the end of the relevant period,^{59/} about \$24,500 represented purchases of securities which were new issues underwritten by registrant or in which registrant was part of the selling group, or sales by registrant out of its trading account as principal.

^{59/} Excluding the gas and oil programs.

Davis

W.B.C. is a naval officer stationed overseas who wrote to Davis in January 1961, stating that Davis had been highly recommended to him and requesting that Davis furnish him "the necessary cards to open an account." As a result, W.B.C. executed a power of attorney or discretionary authority, authorizing Davis to act for him in securities transactions.

W.B.C.'s objective was to be as speculative as possible. There would, therefore, be no purpose in considering the quality of the securities Davis purchased for his account. However, an examination of the source of such securities is appropriate, especially since they were purchased without W.B.C.'s prior knowledge under the discretionary authority. About \$10,300 in securities remained in W.B.C.'s account at the end of the relevant period of which about \$9,500 represented the purchase of new issues underwritten by registrant or sales out of registrant's trading account as principal. Davis also purchased about \$4,500 in securities which were sold during that period. All of those purchases were either new issues *of* which registrant was the underwriter or securities sold out of registrant's trading account as principal.

M.McM. opened an account with Davis in 1958. She and her husband had their first counselling discussion with him in January of 1960. At that time they had about \$4,000 in savings and loan deposits, a 50% interest in real estate valued at about \$10,000 and about \$2,800 in securities which M.McM. had previously purchased through Davis.

The McM.s were newly married, in their late twenties. Their investment objective was to achieve financial independence in the future. Davis assured them that registrant would "be behind" anything he recommended and have "good knowledge of it," that in most cases Hodgdon would be a director and know well what was going on^{60/} and that he, Davis, would not tell them to invest in anything he himself didn't own. Davis said they would have to have complete confidence in him, confide in him totally, have faith in his judgment and that even as small investors, the McM.s would have available to them the services of registrant's experts.

Neither of the McM.s had any prior experience in the securities field and the record is clear that Davis gained their confidence. They followed his recommendations and relied on him totally. They did not, generally, read prospectuses. Davis had told them that these documents always painted a bleak and sad picture and if people based their investment decisions on the prospectuses, no one would ever buy anything.

^{60/} Such representations were repeated from time to time in connection with recommendations for the purchase of securities.

M.McM. purchased eight real estate stocks and syndications for a total of over \$10,000. Invariably Davis' presentation of these securities was made in terms of "yield" or "high yield." Despite Davis' testimony that he made a full explanation of the tax sheltered return to M.McM. at the time she purchased one of the syndication units, it is plain that to her "yield" meant only income in its true sense.^{61/} Indeed, Davis' suggestion that M.McM. use her Putnam shares as collateral for a bank loan at 5½% to purchase Toledo Plaza which would yield 9½% "and that we would really gain" would certainly tend to support M.McM.'s conclusion that the funds she would receive from her Toledo Plaza investment would be "income" which "we would not be reporting for tax purposes."

Davis represented to M.McM. that the stock of Orbit Industries, a new issue which he recommended at \$4, would sell up one to three points in three to six months. The portion of the Orbit prospectus entitled "Speculative Aspects of the Offering" readily^{62/} indicated that his predictions had no reasonable basis in fact.

During the relevant period M.McM. made purchases totalling about \$24,500. The last two purchases in her account were blue

^{61/} "***where Mr. Davis would say, you know, that this is a 9 percent yield or this will be 9 to 13 percent yield, this indicated to me a regular income from this at that percentage."

^{62/} Davis was aware that M.McM. took notes of many of her conversations with him. She admits that she had difficulty where Davis employed technical language or phraseology. Davis has been given the benefit of any reasonable doubt where M.McM.'s notes might be in error for that reason.

chip securities purchased at her insistence for a total of about \$4100.^{63/} Of the remaining \$20,400 all but one purchase for \$436 were new issues of which registrant was the underwriter or securities sold out of registrant's trading account as principal.

^{63/} Davis advised M.McM. that no one ever got rich on blue chips; that the speculative securities would be the blue chips of tomorrow.

Hodgdon

A.S.W. met Hodgdon in 1959. She was the beneficiary of a trust fund and owned securities which were maintained in a custodial account. A Boston bank managed both the trust fund and the custodial account.

A.S.W. informed Hodgdon she would like to increase her income. At Hodgdon's suggestion, the bank transferred municipal bonds having a face value of \$110,000 to her account at registrant. A.S.W. was an inexperienced and unsophisticated investor. She relied on Hodgdon and recalls no instance in which she did not follow Hodgdon's recommendation.

During the relevant period and pursuant to Hodgdon's recommendations, A.S.W. sold some of her municipal bonds and utilized the proceeds thereof to purchase \$40,000 in securities. At least \$30,000 of that amount represented new issues of which ^{64/}registrant was the underwriter or a member of the selling group.

^{64/} It would appear from Hodgdon's testimony, "I think at that time I had available . . . a very small block of Buckingham. . ." that an additional sum of \$4,500 represented the sale of Buckingham securities by registrant out of its trading account as principal.

Others

Mr. and Mrs. E.M.B. opened an account with Harry Ware, one of registrant's salesmen, in May 1960. They advised Ware that their investment objective was to prepare for their retirement and to put two children through college. Their discussions with Ware continued until about February 1961 when their account became active. Prior thereto they had made one relatively small purchase in May 1960. Ware constantly visited their home where he discussed securities with them. He knew they had a portfolio of securities valued at about \$40,000 which they had bought over a period of years.

During the relevant period the B.'s had four different salesmen at registrant's firm. Ware left in the late summer or fall of 1961 and was replaced by Robert Scheutz. William Flynn became their registered representative in 1962 and was succeeded by a Mr. Parks ^{65/} in 1964.

E.M.B. was not a naive investor. She had dealt with broker-dealers before coming to registrant and maintained accounts with other broker-dealer firms while doing business with registrant. Nevertheless, with two exceptions which were her own selections, all her purchases through Ware and Schuetz were the result of their recommendations. E.M.B. purchased about \$14,500 in real estate syndications and real estate stocks. It is abundantly clear, however, that at the time of these purchases E.M.B. had no conception of

^{65/} E.M.B. made no purchases through Flynn or Parks during the relevant period.

the nature of distributions from these securities.

When E.M.B. purchases two units of Rock Creek for \$5,000 in September 1960, Ware told her she would receive a 10% dividend, tax free, that it possibly could be sold in 5 to 7 years and they would be able to realize nice capital gains. E.M.B. knew that this security could not be traded as freely as an ordinary stock. But Ware said they could sell it at any time. In April 1961, Ware recommended Falls Plaza and E.M.B. purchased four units for \$4,000. Ware said it would yield 8% to 13% in dividends, tax free and that in 5 to 7 years the property would be sold and she would receive capital gains. E.M.B. had also purchased several real estate stocks in connection with each of which she was informed that she would receive a tax exempt dividend or a tax-sheltered return or a tax free dividend. It was not until December 1963, upon receiving a communications from the issuer of one of her real estate securities, that E.M.B. realized for the first time that the payments she received included a return of capital.

In August 1961, at Ware's recommendation, E.M.B. purchased over \$2,200 of units of Canandaigua Enterprises consisting of 7% convertible debentures plus common stock. The principal activity of the issuer was the proposed establishment of a race track. E.M.B. told Ware the funds to be used for this purchase were the proceeds of an insurance policy which had been set aside as an educational fund for her daughter, that the funds were not to be risked and had to be available in two years. Ware assured E.M.B. that she would

have a 7% income, the common stock would go up and if anything happened she was preferred and couldn't lose.

E.M.B. testified that when Parks took over her account in 1964 he declared it was the worst list of securities he ever saw and showed it to Haight who agreed. Even respondents are impelled to acknowledge, in their proposed findings of fact and conclusions of law, not only that the recommendations of both Ware and Schuetz were not suitable for E.M.B., but also that registrant's supervisory procedures were deficient.

Between January 1961 and January 1962 E.M.B. sold \$40,700 of her original portfolio securities. between May 1960 and February 1963 E.M.B. made purchases of securities through registrant totalling about \$55,000. \$38,000 of that represented new issues of which registrant was the underwriter or sales by registrant out of its trading account as principal. About \$14,400 of the remaining \$17,000 represented securities purchased by E.M.B. at her own suggestion and selection rather than upon the recommendation of either Ware or Scheutz.

Mrs. M.I.B., a widow, started doing business with Ware in May 1961. At that time she owned 100 shares of South Georgia Natural Gas Co., had about \$5,000 or \$6,000 in savings and earned about \$5,000 a year as a secretary of the Department of Commerce. She expected to retire in about two years and her objective, stated to Ware, was to obtain extra income through investment. M.I.B. mentioned \$100 a month and Ware told her this could be easily realized.

During the relevant period M.I.B. dealt with three different salesmen at registrant. Fray Johns succeeded Ware in the fall of 1961. After Johns left registrant, M.I.B. met a Mr. Resnick at registrant's office. He became her registered representative.

M.I.B. was an unsophisticated investor who relied entirely on her registered representatives. She had engaged in no securities transactions other than her purchase of South Georgia when she came to registrant. Although she received prospectuses, she relied on the oral representations made by Ware, Johns and Resnick. She was unable to distinguish between a return of capital and a return based on profits.

M.I.B. purchased 2 units of Toledo Plaza for a total of \$5,000 in June and July 1961 on Ware's recommendation. He represented to M.I.B. that there would be a 10% return, tax sheltered, that it couldn't miss and was bound to go up. She purchased 1 unit of Cheverly Terrace in February 1962 for \$2,700 and was told by Johns that the return would be 10%, tax sheltered. When she visited registrant's offices in 1963 because she was concerned over her losses in earlier purchases, Resnick assured her she could recoup those losses.

Perusal of M.I.B.'s account discloses that during the relevant period she made purchases of securities totalling over \$19,000. Every security purchased by M.I.B. represented either a new issue in which registrant was underwriter or a security sold out of registrant's trading account as principal. About \$14,000 were used to acquire real estate syndications or real estate stocks, \$2,500 went to purchase a mutual fund stock and \$2,500 to buy speculative securities.

It has long been established that the relationship of a securities dealer or a salesman to an uninformed client is one of trust and confidence which approaches and perhaps equals that of a fiduciary. It arises out of the superior sophistication of the dealer, the reposal of special confidence by the customer in the dealer as specially qualified in the securities field and the dealer's acceptance of this reliance. It imposes upon the dealer the responsibility and duty to act in the customer's best interest in effecting transactions in his account.^{66/}

The circumstances surrounding the opening and subsequent administration of the accounts of the customers referred to above establish the creation of the relationship of trust and confidence between these customers and the respondents with whom they dealt. In most instances the testimony of the customers readily establishes that they were inexperienced and unsophisticated and reposed reliance and confidence in their registered representatives. In two cases where such testimony is lacking,^{67/} the clients' disclosures to Kitain and Haight of their financial resources and clients' acceptance of the financial plans prepared for them demonstrates the relationship of trust and confidence.^{68/} In three instances involving two of

^{66/} Lawrence R. Leehy, 13 S.E.C. 499, 505 (1943); Mason, Moran & Co., 35 S.E.C. 84, 89 (1953); Looper and Company, 38 S.E.C. 294, 300 (1958). See also Haley & Company, Inc., 37 S.E.C. 100, 106 (1956).

^{67/} Kitain's client, A.L.A.; Haight's client, G.M.B.

^{68/} The Ramey Kelly Corporation, 39 S.E.C. 756, 761 (1960).

Carr's customers ^{69/} and one of Davis', ^{70/} all members of the armed forces, a fiduciary relationship is implicit in the existence and utilization of written powers of attorney authorizing Carr and Davis to act in their behalf. Registrant taught its salesmen the practice of inducing customers to repose complete trust and reliance in it. Having successfully achieved the relationship of trust and confidence, registrant and its salesmen took flagrant advantage of their customers and failed to act in their best interests. ^{71/}

The accounts of Adam's clients ^{72/} reveal that 95% and 80%, respectively, of their total purchases of securities during the relevant period represented registrant's underwritings or sales out of its trading account as principal. The accounts of Carr's clients ^{73/} reflect 85% and 87% respectively of such purchases; Kibler's two clients' ^{74/} accounts show 98% and 76%; Kitain's client's ^{75/} account, 83%; Haight's clients' ^{76/} accounts, 98% and 90%; Harper's clients' ^{77/} accounts.

^{69/} G.C.A. and H.C.F.

^{70/} W.B.C.

^{71/} Cf. J. Logan & Co., 41 S.E.C. 88 (1962).

^{72/} G.Y.G. and C.A.S.

^{73/} G.C.A. and H.C.F.

^{74/} D.B.S. and K.F.J.

^{75/} A.L.A.

^{76/} F.E.T. and G.M.B.

^{77/} C.J.M., A.K.D. and C.E.B.

95%, 96% and 67%; ^{78/} Davis' clients' ^{79/} accounts 95% and 97%; Hodgdon's client's account, at least 75%; two accounts ^{80/} of salesmen not ^{81/} named as respondents, 94% and 100%.

The foregoing demonstrates registrant's inordinate concentration ^{82/} on recommendations and selections of securities for its clients from which it could derive the greatest amount of compensation. Certainly, registrant's recommendations could have been made from the virtually unlimited choice available to it on the exchanges and over-the-counter. In that event, of course, registrant would have been restricted to the lesser compensation to be realized from agency transactions.

Moreover, the representations of some of the respondents in relation to anticipated returns from real estate syndication

^{78/} This figure does not take into account the cost of C.E.B.'s purchases of a unit of Canadian Apache 1961 gas and oil program or the cost of one-half interests in two other gas and oil programs.

^{79/} W.B.C. and M.McM.

^{80/} A.S.W.

^{81/} E.M.B. and M.I.B.

^{82/} The Hearing Examiner has attempted to compute only those purchases which passed through registrant's books. This would exclude, for example, mutual fund purchases such as Aberdeen but would include purchases of Putnam.

purchases constituted misrepresentations of material ^{83/} facts and omissions to state material facts. As shown above, Adam, Kibler, Kitain, Haight, Harper, Davis and others not named as respondents represented to their clients, in recommending the purchase of interests in real estate syndications, ^{84/} that they could expect various percentages of return on their investments ranging from 7% to 10% and in one instance as high as 13%, or they represented in reports or analyses to their clients on the status of their accounts that they might expect yields, returns or income of similar percentages. As previously demonstrated, these representations had no reasonable basis in fact either in any of the prospectuses or elsewhere. And

^{83/} "The basic test of materiality * * * is whether a reasonable man would attach importance * * * in determining his choice of action in the transaction in question." List v. Fashion Park, Inc., 340 F. 2d 457 (C.A. 2, 1963); restated in S.E.C. v. Texas Gulf Sulphur Company, ___ F. 2d ___, (C.A. 2, 1968): C.C.H. Fed. Sec. L. Rep. ¶ 92,251. Information disclosing that all or part of the realization from an investment would be a return of capital must be deemed important.

^{84/} No reference has been made, heretofore, to the pertinent portion of the Richmond prospectus. It anticipated that limited partners should receive annual cash distributions of \$130 on each \$1,000 unit, based upon the operations of the issuer during the preceding year. It includes the caveat that the anticipation is neither a promise nor a guarantee. The prospectus breaks down the \$130 figure into taxable income for Federal tax purposes and the return of capital, the latter category constituting the larger portion through the first three years, but cautions against construing the breakdown as the actual relationship that will exist with respect to future anticipated cash distributions.

even assuming that the prospectus of Richmond would support the 7% - 9% representation by Kibler or the "high return" representation by Harper, these statements would, nevertheless, be unwarranted since the customers were not furnished with the information contained in the prospectus as to the portion of the anticipated return which would constitute a return of capital.^{85/}

This conclusion is reached without regard to the inability of the clients to comprehend the complexities which make "tax shelter" possible and give rise to the return of capital. It is also pertinent in that connection that, with the exception of Davis, each of the respondents named above as persons making representations as to a percentage return on syndications had at least one client whose stated objective was either to acquire or to increase his income from investments. Returns of capital do not take the place of true income. Further, Adam's investment summary to C.A.S. stating all income from real estate to be tax free; Haight's report to G.M.B. estimating an increase in income which would, in fact, consist of distributions from real estate investments; Harper's reports to C.E.B. of "yields" from such investments and to A.K.D. of tax free income emphasize the utilization of distributions as a substitute for true income.

Manifestly, Hodgdon, Haight, Carr, Kitain, Adam, Harper, Davis and Kibler are each singly culpable of a breach of their relationship of trust and confidence with the aforesaid clients in selecting

^{85/} Mutual Real Estate Investors, 41 S.E.C. 557 (1963).

so abnormal an amount of securities from which they and registrant would profit most. All except Carr have also singly breached that relationship in their representations to those clients of returns from real estate syndications. As charged in the order for proceedings, they each, together with registrant, engaged in practices which operated as a fraudulent course of conduct in that they induced these customers to repose trust and confidence in them in the belief that they would act in the customer's best interests.

In addition, the consistently high percentage of self-enriching recommendations for security purchases among seven respondents, four of whom were officers of registrant and one a branch manager, and the substantially similar representations of returns from real estate syndications by six of these respondents, discredits coincidence and impels the conclusion that registrant and the above-named respondents engaged in a scheme to defraud.^{86/}

Other representations and activities sustain the allegations of the order for proceedings as to respondents' breach of trust and confidence, lulling and the sale of clients' seasoned securities to purchase unseasoned securities to the benefit of respondent.

Despite Adam's statements in G.Y.G.'s financial plan of the need to keep speculation below 10%, he unjustifiably increased that area to 20%. Although G.Y.G. desired safety in investments, he

^{86/} Cf. Century Securities Company, Securities Exchange Act Release No. 8123 (July 14, 1967); James DeMammos, Securities Exchange Act Release No. 8090 (June 2, 1967).

recommended and she purchased \$11,000 of Paragon stock and \$3,000 of Lord of the Flies stock, both rank speculations. His "congratulations" to G.Y.G. on the state of her account were obviously premature and lulling, as was his extravagant prediction of an increase in the net worth of G.Y.G.'s investments to \$120,000 minimum in the next 5 or 10 years. He recommended the purchase of Wise Homes stock to C.A.S. on the same day he recommended that G.Y.G. sell that stock. He represented to C.A.S. that the syndication properties could be sold in about five years at substantial capital gains, obviously without reasonable basis in fact. His reports to C.A.S., referring to tax free income in respect of syndication investments and his valuation of such investments at cost without attempting to ascertain current prices were attempts to lull the client into a false sense of security.

Kitain's explanation for switching D.G.Y.'s Aberdeen Fund investments to Putnam to achieve the \$25,000 break-point benefits is not persuasive, especially since the sale of the Aberdeen shares involved a loss to D.Y.G. of about \$880. Obviously, the switch assured Kitain commissions on two transactions without awaiting consummation of the second or risking a change of mind by D.G.Y. In fact, D.G.Y. refused to replace the withdrawal in Aberdeen with the result that Kitain realized commissions on total investments of \$50,000 whereas only \$30,000 of mutual fund securities had been purchased. D.G.Y. required liquidity in investments. Nevertheless, Kitain not only

recommended she invest \$10,000 in units of Toledo Plaza but also misrepresented that the units would be marketable. Kitain utilized A.H.R.'s account for his own transactions without A.H.R.'s knowledge. Protestations of friendship hardly absolve this action. His representation to A.L.A. that Wise Homes was better than Jim Walters was unjustified.^{87/} His lulling response to A.L.A.'s inquiry about Wise Homes, i.e., that they wanted the stock to go down, needs no further comment.

Haight failed to recommend to F.E.T. the purchase of any electronics, utilities, or chemical securities in contradiction of the financial plan he proposed. Nor was there any justification for the concentration of real estate securities - over 70% - in F.E.T.'s purchases. Haight's written and oral statements to G.M.B. of increases in income for 1964 to \$5,115 and \$7,000, respectively, predicated upon distributions from real estate investments, was patently lulling. His failure to inform G.M.B. that registrant acted for both the seller and the buyer in respect of her purchases of Falls Plaza, Cheverly Terrace and Toledo Plaza and to advise her of the remuneration or commission received by registrant constituted a violation of Rule 15c1-4 promulgated under the Exchange Act.

Harper's representations to C.J.M. that a real estate syndication unit might be sold in twenty-four hours, that she could benefit

87/ Martin A. Fleishman, Securities Exchange Act Release No. 8002 (December 7, 1966).

from appreciation when the property would be sold in ten years and that she could probably double her money on Lord of the Flies were clearly without reasonable factual bases. The concentration of about 75% of C.J.M.'s total purchases and about 70% of A.K.D.'s total purchases in real estate securities was abnormal. Harper failed to follow his own financial plan for A.K.D. in neglecting to purchase utilities or bank stocks and making only minimal purchases in other categories he stressed. He purchased highly speculative oil programs despite the client's insistence on safety in investments. He lulled her with assurances of huge profits, i.e., "we'll keep you comfortable at the \$500,000 to \$750,000 level";^{88/} with projections, on September 28, 1962, of income of \$15,000 to \$18,000 by 1964 in the face of actual income of about \$5,200 for the period January through September 1962; with reports of "yields" and distributions from real estate as tax protected income. For reasons similar to those stated in respect to A.K.D., Harper failed to adhere to his financial plan for C.E.B. He also lulled C.E.B. with reports of "yields" from real estate distributions.

Davis' misguided advice to M.McM. to ignore prospectuses as a basis for investment decision was patently inconsistent with his duty to her. His representation that the stock of Orbit would rise 1 to 3 points in 6 months had no reasonable basis in fact.

^{88/} A.K.D. had a portfolio of securities valued at about \$200,000. The account had just been opened.

Ware's statements to E.M.B. in respect of her Canandaigua purchase present a glaring fraud.

Hodgdon created registrant's method of operations and as principal stockholder benefitted most from its activities. He was in over-all charge of its affairs. He prepared the registrant's advertising material which was designed to entice the unsophisticated investor.^{89/} He selected its underwritings and the securities in which it traded and knew or should have known of the magnitude of the purchases by registrant's customers of such underwritings and securities. Indeed, much of the teachings of the training courses under the guise of tax savings, were designed to foster the sale of real estate and gas and oil securities either underwritten by registrant or of which registrant was part of the selling group. It is noteworthy that between 1960 and 1962 inclusive, during which period a substantial portion if not most of the transactions here involved occurred, registrant averaged 47% of its income from underwritings alone. The more definite statement filed by the Division omits to name Hodgdon as one of the respondents, singly, who failed to supervise. But, in addition to his activities set forth above in respect of his client, Hodgdon "must share responsibility for the fraud by virtue of his knowledge of and participation in managing registrant's affairs."^{90/}

^{89/} "The Commission's duty to protect the gullible is apparent. And, we have held it is not improper to judge advertisements by their impact on the segment of the public at which they are aimed." Marketlines, Inc. v. S.E.C. 384 F. 2d 264 (1967); cert. den. 390 U.S. 947.

^{90/} Cf. Melvin Hiller, Securities Act Release No. 8476 (December 24, 1968).

Haight was vice-president in charge of sales throughout the relevant period. Carr was senior vice president, a member of the board of directors, owner of more than 10% of registrant's stock, conducted training sessions on sales techniques and real estate and was available for consultation on financial plans. In addition to culpability for their activities in respect of their clients' accounts described above, both are responsible, as charged, for failure reasonably to supervise registrant's registered representatives with a view to preventing the fraudulent course of conduct found above.^{91/}

Registrant, of course, is responsible for the acts of its agents.^{92/}

Accordingly, it is concluded^{93/} that in the offer and sale of securities, registrant, Hodgdon, Haight, Carr, Kibler, Kitain, Adam, Harper, and Davis willfully violated and aided and abetted willful violations of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder;^{94/} and registrant, Haight and Carr willfully violated Section 15(b)(5)(E) of the Exchange Act.

^{91/} Kitain, although designated a branch manager, was not assigned any supervisory functions.

^{92/} Armstrong, Jones and Company, Securities Act Release No. 8478 (December 27, 1968).

^{93/} Proof by a preponderance of the evidence is "the standard consistently used in broker-dealer administrative proceedings." Norman Pollisky, Securities Exchange Act Release No. 8381 (August 13, 1968), and the standard of proof used in making and reaching the findings of fact and conclusions of law in this initial decision. Respondents' implicit suggestion that a different standard may apply is untenable.

^{94/} A finding of willful violation does not require a showing of intent to violate the law. "It is sufficient that the person charged with a duty intends to do the act which is violative of the statute." Norman Pollisky, supra.

Sale of Unregistered Securities

A. U. S. Infrared Corporation

U. S. Infrared Corporation ("USI") was incorporated in the District of Columbia in August 1960 by Amann and others, as promoters, to develop and produce an infrared radiation detection device which had been invented by Patrick McCarthy ("McCarthy"). The principal purpose of the device was to detect overheating in mechanisms. At the time of USI's incorporation, McCarthy was engaged in discussions with the Pennsylvania Railroad regarding the detection of overheated railroad hotboxes.

Amann was then a vice president of registrant. He brought USI to Hodgdon's attention and suggested that registrant undertake sale of USI stock as a private placement.^{95/} Hodgdon spoke with McCarthy and reviewed the USI situation. He then advised Amann that he was unimpressed with McCarthy and found USI unattractive. Other officers of registrant, including Haight, also attempted to discourage Amann from continuing with the USI project. Upon Amann's insistence that he was already committed and had interested some of registrant's salesmen, Hodgdon agreed to allow Amann to proceed with a private placement of USI stock, but admonished that he was not to commit or involve registrant in the future without Hodgdon's knowledge.

^{95/} Sections 5(a) and 5(c) of the Securities Act, as applicable here, make it unlawful to use the mails or interstate facilities to sell or deliver, or offer to buy or sell a security unless a registration statement is in effect as to such security. Under Section 4 of the Securities Act, the provisions of Section 5 do not apply to transactions by an issuer not involving any public offering.

Nevertheless, Hodgdon issued a memorandum directed to all registered representatives dated August 19, 1960, before any sales of stock had been effected, advising that commitments had been made in respect of USI without the approval of registrant's management and that rather than embarrass the member concerned by terminating his relationship with USI, the salesmen should consider the following before offering USI stock to their clients:

- "1. It is our opinion that Infra Red is a gross speculation. There is no semblance of a management team and none in sight.
2. Thousands of companies with interesting products in the scientific and electronic domain have gone bankrupt.
3. We take a dim view of time spent on projects which do not meet with the approval of the firm."

The memorandum also requested each salesman to submit a list of customers he intended to approach and warned that in order to pass as a private placement the combined total number of purchasers must not exceed 25 persons. It also stated that all salesmen were to inform their clients that registrant regards this situation as too speculative to merit approval at this time. All salesmen interested in offering USI stock to their clients were required to sign the letter of August 19, 1960. Hodgdon caused the price of the USI stock to be increased from \$1.00 per share to \$1.10 per share, the increase to represent registrant's compensation. Between August 30, 1960 and October 7, 1960 registrant sold 45,430 USI shares at \$1.10 per share to 18 purchasers.

Registrant received its compensation of \$.10 per share. 96/

It is readily apparent from Amann's testimony 97/ that USI was insolvent at its inception. It is unnecessary to recount the various problems USI met during its short existence, both financial and technical, in the development of its devices. It is sufficient to state that neither the infrared pistol, later known as the Telerad, nor the various other infrared devices which USI attempted to develop to meet the requirements of the Pennsylvania Railroad ever found acceptance by the railroad or succeeded as a marketable item. McCarthy died in December 1960 and operation of USI was taken over by Phillip Luckhardt who had been hired earlier as a marketing and management expert with the title vice president and secretary. The enterprise collapsed in the late fall of 1961. Efforts to sell its products to other electronic firms on a royalty basis were unsuccessful.

During its existence USI was financed through two purported private offerings in addition to the sale of the 45,430 shares referred to above. In a memorandum dated April 20, 1961, directed to "Stockholders, U.S. Infrared Corporation, signed by Amann, "Chairman, Executive Committee" and Luckhardt, "Vice President and Secretary of the Corporation," USI offered stockholders the right to purchase "one share for each three shares now held, at a price of \$1.25 per share." The statement of income attached to the memorandum

96/ Respondents admit that no registration statement was filed in respect of USI.

97/ Amann testified, in substance, that prior to the organization of USI, McCarthy worked out of Ford Studebaker's shop on funds advanced by Studebaker.

disclosed a net loss of \$11,806 for the period August 18, 1960 through April 19, 1961. USI succeeded in raising \$8,000 through this offering. .

Finding itself again in need of funds, USI issued a letter dated July 21, 1961 advising stockholders that it had signed an underwriting agreement with a Washington investment firm for the public sale of 130,000 shares at \$2 per share. The letter offered its stockholders unsecured \$1,000 convertible debentures. It also stated that the stock to be acquired by debenture holders through conversion of the debentures "will be registered with the S.E.C. under a 'long form' registration, and thus immediately liquidable [sic] upon going public." The letter was signed by Amann as "Chairman, Executive Committee, U. S. Infrared Corporation, Vice President, Hodgdon & Co." A progress report accompanying this letter included a memorandum by Amann dated July 19, 1961, entitled "To Interim Financial Interests," signed by him as "Vice President, Hodgdon & Co., Chairman, Executive Committee U. S. Infrared." This memorandum assured a public underwriting "so that the interim financial interests can liquidate at market prices immediately upon the public offering." It also refers to the corporation as having "two ready products for military and commercial use."^{98/}

When the letters referred to above were brought to Hodgdon's attention he discharged Amann from registrant and sent a telegram to purchasers of USI stock stating that the letters of July 19, 1961

^{98/} USI realized \$15,000 from the sale of these debentures.

and July 21, 1961 were not submitted to registrant for approval, that registrant disavows all literature sent to customers since Amann had no "right or reason" to write as vice president of registrant and indicated Amann is resigning from registrant.

At or about the time of the first offering Amann received ^{99/} 25,000 Class B Shares of USI for services rendered, 5000 of which he turned over to registrant. A total of 58,000 Class B shares had been distributed among Amann, McCarthy, Ford Studebaker, who had financed McCarthy before the organization of USI, counsel for the corporation, and the corporation's accountants, all for services rendered. During its existence every balance sheet issued by USI showed a deficit or net loss. The Statement of Income for the period August 18, 1960 through April 19, 1961 showed a net loss of \$11,806. USI's balance sheet as of May 31, 1961, showed a deficit of \$21,467; as of June 30, 1961 a net loss of \$19,072.31;^{100/} as of July 31, 1961 a net loss of \$24,940.89.

Four of Amann's customers testified to purchases of about 9,500 shares of USI stock and a \$10,000 debenture.

J.A.R. had become a client of Amann's in the fall of 1959 as the result of a cold call. He testified that at Amann's recommenda-

^{99/} The difference between the Class A and Class B shares was that the latter would not share in any dividends or liquidation for a period of one year.

^{100/} The reduction in net loss for June 30, 1961 from the May 31, 1961 figures arises from USI's sales of a product known as Acquitrol for which it had become the distribution agency. It soon developed, however, that problems with the product caused cancellation of so many of its sales that the experiment was short-lived and sales of Acquitrol reflected in the June 30, 1961 figure were substantially unrealized.

tion he purchased 2,000 shares of USI stock in late August 1960. Although Amann explained the infrared device to J.A.R. he furnished no literature regarding USI and told J.A.R. nothing of the distribution or proposed distribution of USI Class B shares to promoters, management and others for services rendered.

S.L. bought 2,000 shares of the original USI issue as a result of Amann's recommendation. He knew that the stock was not registered but received no literature relating to USI and no information regarding the distribution of USI shares to promoters, management and others for services. S.L. also purchased 2,667 shares of USI stock as a result of the April 1961 solicitation and received the USI offer relating to the sale of debentures in July 1961.

I.J.W. purchased 1,820 shares of USI in August 1960. Amann explained the infrared pistol and that it was not yet fully developed. I.J.W. received no brochure on USI but believes there may have been some indication that McCarthy and others were receiving stock in consideration for services rendered.

A.P.S. bought convertible debentures totalling \$10,000 in July 1961 through Amann. He did not receive a brochure or other literature and since he was not a stockholder of USI he did not receive the solicitation letter of July 21, 1961.

Although F.C. did not testify, the record discloses that Amann sold 1,000 shares of USI to him at the time of the original offering. Amann refers to F.C. as one of the people who

"bought stock behind me." Apparently this description also includes others who purchased about 4200 shares.

Amann approached Davis, one of the respondents herein, who invested a total of about \$1,800 on three different occasions. Davis' testimony discloses that at the time of the first purported offering of USI stock Amann told him about the device, the purposes of the company and the use to which they proposed to put the device in relation to railroads and fire detection. Davis never saw a demonstration of the device nor is there any indication in his testimony that he received any literature or any advice regarding the distribution of shares to promoters, management and others for services rendered.

Kitain sold about 6,200 shares of USI stock to four customers.

A.H.R. was one of Kitain's financial planning clients. He bought 1,500 shares in August 1960 and an additional 500 shares during the April 1961 offering. A.H.R. testified that he received no literature. Although Kitain stated that A.H.R. received a report, the document to which he refers consisted of a description of the devices USI proposed to develop, the proposed use of the proceeds of the sale of stock and a description of management personnel. The report lacked financial data and any reference to the distribution of Class B stock to management and others. It is sufficient that respondent's brief admits that " . . . Kitain did not go into [USI's] financial situation and did not state that management had received

stock in consideration for services rendered . . ."

A.R.M., to whom Kitain sold 1,200 shares during the first offering and an additional 400 shares during the second offering in April 1961, saw a copy of the same report Kitain insisted had been shown A.H.R. Even accepting Kitain's testimony that he had informed A.R.M. that McCarthy had received Class B stock, the record contains no indication that he was advised that other shares had been distributed.

Kitain also sold 1,000 shares to D., his father-in-law and 2,000 shares to B. through the mails. Neither appeared as a witness. Kitain's testimony that the necessary information on USI was transmitted to B. in a two or three page handwritten letter hardly compels the conclusion that B. was furnished all pertinent information.

W.D.S. was Roper's customer. He had attended a meeting in registrant's offices at which the device was tested. He purchased 2,000 shares of USI in September 1960 but received no literature and no information regarding USI's financial condition.

A.A.C.R. purchased 1,000 shares of USI through Roper in August 1960. Roper told him little, if anything, about the company except the proposed use of the device.

R.M.O., a salesman of Apache's oil programs, purchased 2,300 shares of USI through Freed in August 1960. Freed furnished R.M.O. with a report on USI, but the report contained neither financial information nor advice as to the distribution of Class B shares to promoters and others.

M.K. and B.B. were both members of an investment club.

Freed addressed one of the club's meetings as a result of which the club purchased 1,000 shares of USI on September 1, 1960. They were furnished nothing beyond Freed's oral statements regarding the device and its potential.

B. Paragon

Paragon Electric Manufacturing Corporation ("Paragon") was organized as a Maryland corporation in February 1960 to develop, produce and market for the building trade a reusable crimp type wire connector known as the Bucap or Dycap. The Bucap and the Bucapper, a companion tool used to crimp the Bucap, were both developed by Stephen R. Buchanan ("Buchanan").

The promoters of Paragon were Buchanan, who had little proficiency as a business man, Carl Gentry, who operated a machine shop but had no experience in the electrical field, George W. Owens ("Owens"), his employee and Leo Goodwin, Jr. ("Goodwin"), a wealthy official of an insurance company. Late in 1960 Paragon sought to raise capital. After initial discussions between Haight and the promoters, registrant was furnished financial statements and projections of operations and sales. The projections were optimistic, but the company had done no market testing.

In December 1960 the promoters met with Hodgdon, Haight and Guy Luttrell, registrant's executive vice president, at registrant's offices. Luttrell's functions included the investigation of real estate and industrial situations to determine whether registrant should undertake underwritings. Registrant was made aware that

Paragon had no tools or production parts. Samples of the products had been prepared from temporary molds. The Bucap design was stable but the Bucapper or tool had many bugs.^{101/} The company had orders, for the Bucap only, amounting in all to several hundred dollars. Goodwin had made loans to the company when its initial funds were exhausted. During the discussions with registrant "it was determined that finances were in short supply." The company had been subsisting on the funds borrowed from Goodwin totalling \$40,000.

Hodgdon sought assurance from Goodwin that if registrant decided to sell the Paragon stock, the proceeds thereof would not be used to repay his loans. Goodwin rejected Hodgdon's request that he sign an agreement to that effect but indicated, orally, that he had no intention of collecting the indebtedness at that time.

On January 17, 1961, registrant undertook to privately place 20,000 Paragon shares at \$5.50 per share.^{102/} All the shares were sold between February 3, 1961 and February 27, 1961 to thirteen purchasers. Paragon never got off the ground and in April 1963 filed a voluntary petition in bankruptcy. An investigation of Paragon's affairs authorized by and at the expense of registrant, after the bankruptcy, disclosed that \$39,699 of the proceeds of the private placement had been used to repay the Goodwin indebtedness. Although

^{101/} Eventually, it was abandoned.

^{102/} No registration statement was ever filed.

Luttrell had maintained liaison with Paragon, registrant first learned of the repayment of the Goodwin indebtedness as a result of the investigation.

Several witnesses to whom a total of 8,550 shares of Paragon were sold by registrant's representatives testified to the circumstances surrounding their purchases.

Carr sold 2,000 shares of Paragon stock to D.B.A. and a similar amount to G.E.A., a financial planning client. D.B.A. was furnished no information of any kind, financial or otherwise, beyond a description of the device Paragon proposed to develop. Although G.E.A. read extensive material on Paragon's management personnel, it is apparent that he was furnished no financial data and knew nothing of the company's indebtedness to Goodwin.

Four customers^{103/} purchased 4,500 shares of Paragon stock through three of registrant's representatives. None of these customers were furnished any financial or other information regarding Paragon other than a description of the devices proposed to be developed. One saw a pamphlet containing pictures of the Bucap and Bucapper and visited Paragon's plant prior to his purchase.

C. Data Processing Corporation of America

Data Processing Corporation of America ("DECA") was organized by H. Jefferson Mills, Jr. ("Mills") in 1959. As expressed in certain literature prepared for DPCA, its primary objective was to establish and operate data processing service centers in various metropolitan areas serving business, industry and government.

^{103/} M.S., A.A.C., W.D.S. and A.H.C.R.

At Mills' request, Amann commenced advising Mills as to methods of financing DPCA. Amann anticipated receiving a finders fee of $\frac{1}{2}$ of 1% and an agreement to that effect was prepared but never signed by DPCA. Later it was agreed that "founders stock" would serve as Amann's fee in place of cash.

In 1960 Amann introduced Mills to Hodgdon for the purpose of having registrant consider the underwriting of an issue of DPCA stock. In March 1961, DPCA prepared a brochure offering 4,000 shares at \$3.50 per share "on a private basis only," for a total of \$14,000. Mills and Hodgdon met again in March and June 1961. At the last meeting Hodgdon refused to underwrite a DPCA issue but advised Mills that registrant would be interested in becoming a member of a selling group if a major broker-dealer would be the underwriter.

DPCA's main prospect lay in its negotiations with Aberdeen Fund for the furnishing of data processing services but they proved fruitless. The enterprise failed. 104/ No public offering was ever made. In February 1964 DPCA's counsel advised that DPCA had no assets.

From March through May 1961, before Mills' final conference with Hodgdon, Amann commenced purchasing DPCA shares. He also interested registrant's registered representatives who purchased the stock for themselves and their customers. Admittedly, no registration statement had been filed with respect to DPCA's shares.

104/ A document dated June 30, 1961, prepared to induce an underwriting of an issue of DPCA stock, includes a statement of financial condition which discloses deficits as of December 1960 and May 31, 1961.

Amann bought 3,500 shares of DPCA stock, some at \$2 and some at \$3.50 for a total of \$8,400. He retained 1,100 shares, sold 400 shares to his customers, 1,800 shares to Kitain, 100 shares to Haight and 100 shares to Freed. All checks covering purchases of DPCA stock were made to Amann's order and the proceeds paid over by Amann to DPCA. 105/

Amann testified that he showed some of the purchasers the March 1961 brochure prepared for the purported private offering of 4,000 shares. He did not name these purchasers. The brochure describes business, management, aspirations, capitalization and stock ownership of the corporation, but contains no financial statements or other financial information. Amann agrees that he did not tell purchasers of DPCA's financial condition. Indeed, his proposed findings state only that he "spoke to Burton Kitain and Homer Davis about DPCA stock" and "suggested to James F. Haight and Samuel A. Freed that each of them may want to purchase 100 shares of DPCA."

Amann approached Kitain and furnished him with the March 1961 brochure. Kitain purchased 600 shares of DPCA for his own account and, in addition, sold 100 shares to D. and 100 shares each to two customers, A.H.R. and A.L.A., whose accounts have been discussed supra. Neither was furnished any literature or financial

105/ None of the DPCA transactions were put through registrant's books. Every effort was made by Amann and other registered representatives who sold DPCA shares to keep Hodgdon in ignorance of these transactions. When they were brought to his attention in February 1962 inadvertently, through the complaint of a customer, he severely rebuked all those involved.

information regarding DPCA. Kitain asserts that he told A.H.R. all he knew. But he saw only the March 1961 brochure which contained no financial data. His proposed finding in respect of A.L.A. indicates he told her only that the investment was highly speculative.

Davis utilized his discretionary authority to sell 100 shares of DPCA to W.B.C. The record discloses only that Amann "spoke to * * * Davis about DPCA stock" as shown above.

It is well settled that the exemption from registration by an issuer provided by the former Section 4(1) of the Securities Act,^{106/} which exempted transactions not involving any public offering of securities, is not available unless the persons to whom the offer is made are shown to have the same kind of information in respect of the issuer as would have been disclosed by a registration statement or to have access to such information.^{107/} Moreover, the burden of proving entitlement to the exemption from registration is not only on the issuer,^{108/} but also on the broker-dealer who claims the benefit of the exemption.^{109/}

It is abundantly clear that none of the persons to whom respondents sold the stock of USI, Paragon or DFCA were furnished the necessary financial or other information. The literature a few such customers received contained no financial data. None of the

^{106/} Now Section 4(2).

^{107/} S.E.C. v. Ralston Purina Co., 346 U.S. 119 (1953); Gilligan Will & Co. v. S.E.C., 267 F.2d 461 (C.A. 2, 1959), cert. den. 361 U.S. 896. Strathmore Securities, Inc., Securities Exchange Act Release No. 8207 (November 13, 1967).

^{108/} S.E.C. v. Ralston Purina Co., supra.

^{109/} Gilligan Will & Co. v. S.E.C., supra.

purchasers of USI stock, with one exception, was informed of the substantial number of the issuer's shares held by promoters and others. The vague statement to that exception, i.e., that McCarthy and others were receiving shares, is hardly adequate. None of the purchasers of Paragon stock were advised of the obligation to Goodwin which constituted about 40% of the proceeds of the offering or that the proceeds would be used to repay that obligation. Nor can the technique of mechanically obtaining investment letters from some of the purchasers frustrate the basic policy of registration under the Securities Act.^{110/} Such investment letters are "necessarily self-serving and not conclusive as to their actual intent." ^{111/} Indeed, Amann signed such a letter in USI but, nevertheless, sold some of his shares to his customers.

Since respondents have not sustained the burden of proof that the purchasers of the three offerings were able to fend for themselves,^{112/} it is concluded that they were public offerings requiring registration under the Securities Act.

Respondents urge that since none of the three unregistered securities were offered to more than 25 persons, the statutory exemption provided by the former Section 4(1) of the Securities Act was available to them. This position is predicated upon the publication

^{110/} Elliot & Company, 38 S.E.C. 381, 395 (1958).

^{111/} Strathmore Securities, Inc., supra, See also B.F. Bernheimer & Co., Inc., 41 S.E.C. 358, 363 (1963).

^{112/} S.E.C. v. Ralston Purina Co., supra, p. 125.

in the Federal Register (11 Fed. Reg. 10952, 1946) of a letter form of release by the General Counsel written in 1935^{113/} which stated, in substance, that the Commission had previously expressed the opinion that an offering to an "insubstantial number of persons" is an exempted transaction under Section 4(1) and that an offering to "not more than approximately twenty-five persons is not an offering to a substantial number and presumably does not involve a public offering." Respondents assert, that the release had not been revoked or amended at the time of the three purported private offerings and was, therefore, binding on the Commission.

However, respondents overlook the fact that the portion of the release on which they rely was merely an introduction to the Commission's interpretation of the availability of the Section 4(1) exemption. It was not intended to, and did not in fact, represent the Commission's position as is demonstrated by the excerpts set forth below which follow the introduction and which negate respondents' position.

"I would call your attention to the fact that in previous opinions it has been expressly recognized that the determination of what constitutes a public offering is essentially a question of fact, in which all surrounding circumstances are of moment. In no sense is the question to be determined exclusively by the number of prospective offerees. I conceive that the following factors in particular should be considered in determining whether a public offering is involved in a given transaction." (underscoring supplied)

The release then raises a number of factual circumstances which would give rise to serious question regarding the availability of

^{113/} Securities Act Release No. 285, January 24, 1935.

the exemption regardless of the number of persons to whom the security may be offered,^{114/} including the statement:

"I also regard as significant the relationship between the issuer and the offerees. Thus, an offering to the members of a class who should have special knowledge of the issuer is less likely to be a public offering than is an offering to the members of a class of the same size who do not have this advantage. This factor would be particularly important in offerings to employees, where a class of high executive officers would have a special relationship to the issuer which subordinate employees would not enjoy."

^{115/}

Accordingly, respondent's contention is rejected.

The more definite statement furnished by the Division omits the names of Hodgdon and Haight in designating those charged "singly" with violation of Sections 5(a) and 5(c) of the Securities Act. Division, nevertheless, seeks a finding that Hodgdon and Haight also violated those sections.

Despite Amann's attempt to conceal the DPCA transactions from registrant it cannot escape responsibility for the actions of the registered representatives. Amann was an officer of registrant. Its

^{114/} Cf. S.E.C. v. Ralston Purina Co., supra, stating: "But the statute would seem to apply to a public offering whether to few or many." p. 125.

^{115/} In his article, "Some Observations on the Administration of the Securities Laws", 42 Minn. L. Rev. 25 (1957), former Commissioner Orrick referred to a "rule of thumb" that "an offering made to not more than 25 or 30 persons who take the securities for investment and not for distribution, is generally a private transaction not requiring registration." But the "rule of thumb" offers little comfort to respondents since Commissioner Orrick surrounds that statement with assertions that the principal test is not numbers, but whether the offerees need the protection afforded by registration.

registered representatives sold DPCA stock to registrant's customers. Haight, a vice president, purchased DPCA stock for his own account and therefore was aware of the offering and of Amann's activities. The offices of registrant were undoubtedly used in effecting sales of the stock. Registrant, therefore, is responsible for the acts of its agents in the sale of DPCA stock as well as the stock of USI and Paragon. Hodgdon, having selected USI and Paragon as private offerings to be sold by registrant and by virtue of his position in management bears responsibility for the sale of those issues. In addition, for the reasons set forth above in respect of respondents' failure to act in the best interests of their clients, Haight and Carr also bear responsibility, as charged, for failure reasonably to supervise registrant's salesmen with a view to preventing these violations.

It is concluded, therefore, that registrant and Hodgdon, together with Carr in the offer and sale of the stock of Paragon and with Amann and Kitain in the offer and sale of the stock of USI, willfully violated Sections 5(a) and 5(c) of the Securities Act, and that registrant together with Amann, Kitain and Davis willfully violated that statute in the offer and sale of the stock of DPCA. It is concluded, further, that Haight and Carr willfully violated Section 15(b)(5)(E) of the Exchange Act in connection with the offer and sale of the stock of Paragon and USI and that Haight willfully violated that section in respect of the offer and sale of the stock of DPCA.

Misrepresentations and Omissions of Material Facts

USI

Although Amann's customers were made aware that the U.S.I. stock was highly speculative, he, admittedly, does not believe he showed registrant's memorandum of August 19, 1960 to all his ^{116/} USI investors. At least one ^{116/} denied being informed of registrant's poor opinion of the stock and was told by Amann that the device was well received by the railroad and that the results were excellent. None were advised of USI's financial condition and ^{117/} at least two had no information regarding the distribution of Class B stock to promoters and others. Amann represented to one customer that U.S.I. had tremendous potential and offered the customer an opportunity to get in on the ground floor before the company went public through registrant who might be interested in ^{118/} it later. Amann's letter of July 21, 1961, soliciting purchasers for USI's convertible debenture, stated that the stock to be acquired upon conversion of the debentures "will be registered" and "immediately [become] liquidable." ^{119/} The purchaser of the \$10,000 ^{120/} debenture was not told by Amann, in advance of his purchase, that

^{116/} J.A.R.

^{117/} J.A.R., S.L.

^{118/} S.L.

^{119/} S.L. received this letter.

^{120/} A.P.S.

the bond was unsecured or that Amann personally would receive a commission of 10% on the transaction. Moreover, Amann represented to him that he had received an engineering report on the device that was "fantastic"; that it was made by foreign engineers which would give the product a potential foreign market and that USI had only a small amount of stock outstanding and he visualized the common stock (to which the bonds were convertible) as "really rising."

Two witnesses testified to purchases of USI stock from ^{121/}Kitain. Both knew that this was a speculative venture but neither was informed of USI's financial condition. A.H.R. was told nothing regarding the Class B shares distributed to promoters while A.R.M. was informed only of McCarthy's shares. Kitain does not deny that A.H.R. invested "with the understanding that my investment would ultimately, when the issue went public, be translated into securities at a certain price." Kitain represented to A.R.M. that the venture would be profitable, that USI would go public at a higher price later and that the customer was coming in on the ground floor. Kitain testified he stated, instead, that the company would have to have some kind of an offering sometime in the future to establish a market. But the customer's testimony in respect of Kitain's representation at the time of his second purchase of 400 shares during the April 1961

^{121/} A.H.R., A.R.M.

offering, that this was an opportunity to come in at a more favorable price since there would be a public offering at a higher price later, remains uncontradicted.

122/

Two of Roper's customers, to whom he sold a total of 3,000 shares, were furnished no information relating to USI's financial condition or to the Class B shares distributed to promoters. W.D.S. was not advised of the contents of registrant's memorandum of August 19, 1960.

R.M.O., to whom Freed sold 2,300 shares, was not furnished financial information or advice regarding the distribution of Class B shares. He was not made aware of registrant's attitude toward this venture. Moreover, an investment club which Freed addressed and which purchased 1,000 shares lacked the same information Freed failed to furnish R.M.O. In addition, Freed represented that the company would have insurance on McCarthy's life. The application for such insurance was rejected.

122/ W.D.S. and A.A.C.R.

In making the optimistic representations, by Amann in respect of USI's tremendous potential, by Kitain as to its prospective profitability and by both as to the advantages to be gained by purchasing before USI went public, Amann and Kitain impliedly ^{123/} represented the existence of an adequate basis therefor. In the light of the facts set forth above, it is manifest that at the time of USI's first offering there was no basis in fact for such representations. Registrant's memorandum of August 19, 1960 must have put them on notice of the lack of foundation for their statements. Nor did USI's situation improve with the passing of time. It remained insolvent. Its deficiencies and losses merely increased. Their representations were, therefore, contrary to the basic obligation of fair dealing imposed on those who engage in the sale of securities to the public. The "fantastic" report to which Amann referred was non-existent and his visualization of the price of the stock "really rising" was misleading and ^{124/} fraudulent.

In addition, Amann and Kitain omitted to inform their ^{125/} customers of USI's adverse financial condition, of the Class B

^{123/} Aircraft Dynamics International Corp., 41 S.E.C. 566, 570 (1963).

^{124/} MacRobbins & Co., Inc., 41 S.E.C. 116, 119 (1962), aff'd sub. nom. Berko v. S.E.C., 316 F. 2d 137 (C.A. 2, 1963).

^{125/} Cf. Sanford H. Bickart, Securities Exchange Act Release No. 8269 (March 8, 1968).

shares which had been issued to USI's promoters and others and of registrant's memorandum of August 19, 1960. These omissions constituted further violations of the anti-fraud provisions of the securities laws. ^{126/} Known or easily ascertainable facts bearing on the justification for the recommendation should accompany ^{127/} it. The misrepresentations are not less improper because the customers were advised that the stock was speculative ^{128/} or ^{129/} because Amann and Kitain, themselves, purchased USI stock.

Other salesmen of registrant omitted to advise their customers of registrant's financial condition, the contents of registrant's memorandum of August 19, 1960 and the distribution of Class B stock and one salesman falsely stated that USI had insured McCarthy's life. Moreover, Hodgdon's undertaking to sell the USI stock despite his unfavorable attitude toward the company indicates his willingness to disregard the basic requirement for fair dealing in favor of a profit.

Paragon

Carr represented to D.B.A. that the Bucap would be distributed by General Electric and Westinghouse; that the customer should buy before Paragon went public and he would make a profit

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- ^{126/} N. Pinsker & Co., Inc., 40 S.E.C. 285, 291 (1960)
^{127/} Martin A. Fleishman, Securities Exchange Act Release No. 8002 (December 7, 1966); Albert J. DiGiacomo, Securities Exchange Act Release No. 7572 (April 12, 1965).
^{128/} Commonwealth Securities Corporation, Securities Exchange Act Release No. 8360 (July 23, 1968)
^{129/} Alfred Miller, Securities Exchange Act Release No. 8012 (December 28, 1966)

after it went public; that there had been talk of a stock split before the public offering. Carr's testimony failed to refute any of these statements. Carr failed to advise D.B.A. of Paragon's adverse financial condition.

Goldberg, one of registrant's salesmen, represented to M.S. that Paragon's devices would have good market reception, that the items were patented and that the Navy would set up a small plant to handle the items. M.S. was not furnished financial information.

Registrant's confidential report on Paragon dated January 17, 1961, directed to "All Representatives", carried references to the distribution of Paragon's products to be made "through already well established dealers in the trade;" and asserted that "although the stock is speculative, projected profits seems (sic) suitable as well as realistic and market potential appears sufficiently significant to insure a good return on an investment in this Corporation."

Owens testified that Paragon never attempted to publicly offer its stock, that it had no licensing agreements with any company with respect to any of its products and that a split of Paragon stock was never proposed. Carr's statements of distribution of Paragon's products by General Electric and Westinghouse, of a forthcoming public offering ^{130/} and talk of a stock split were unjustified

^{130/} Cf. Charles P. Lawrence. Securities Exchange Act Release No. 8213 (December 19, 1967).

misrepresentations, having no reasonable basis in fact. His failure to inform his customer of Paragon's poor financial condition also violated the duty of a dealer in securities to fully disclose all the material facts.

Goldberg's and Roper's representations were equally unwarranted. There had been no discussions regarding a plant with the Navy and Paragon's products were not patentable.

Registrant's confidential report to its salesmen was an unsupportably over-optimistic evaluation of the facts available to it, prepared for the sole purpose of stimulating the sale of Paragon stock. Further, Hodgdon was not justified, in the absence of a firm agreement with Goodwin, in assuming that the proceeds of the offering would not be used to repay Goodwin's loan.

DPCA

Kitain represented to A.H.R., who purchased 100 shares of DPCA stock, that there was a good possibility that DPCA would get a contract from Aberdeen Fund.

Amann sold R.S. 100 shares in May 1961. He represented to this customer that DPCA was working diligently on a public offering.

Davis purchased 100 shares of DPCA stock for W.B.C., a member of the armed forces who had given Davis discretionary authority over his account. Davis wrote W.B.C. in June 1961 that "there

will be an initial public underwriting late this year or early next year. This also will be a small limited public offering. Those buying at that time will no doubt have to pay considerably more than the \$3.50 which represents our cost base."

The above named respondents had no reasonable bases for the statements and predictions they made. DPCA's negotiations with Aberdeen never reached the point where an agreement for DPCA's services could reasonably have been anticipated or even described as a "good possibility" and the representation was, therefore, ^{131/}misleading. Mills' intermittent casting about for an underwriter of DPCA securities hardly justified either assurance of a public offering or the implication of such assurance present in the representation that DPCA was "working diligently" toward that end and these statements were unjustified. Even assuming a reasonable expectation of a public offering, the prediction that the price of the stock on the future offering would exceed the original purchase price was utterly without foundation and, in view of the unseasoned ^{132/}and speculative nature of the stock, could not be justified.

^{131/} Cf. Albion Securities Company, Inc., Securities Exchange Act Release No. 7561 (March 24, 1965).

^{132/} Cf. Linder, Bilotti & Co., Inc., Securities Exchange Act Release No. 7460 (November 13, 1964).

Van Pak, Inc.

Van Pak was incorporated under Iowa law in August 1959. It was the successor to a firm of the same name that had been certified as an Interstate Commerce Commission carrier and had become inactive in 1957. Charles N. Barrett ("Barrett"), Van Pak's president, had been a principal of its predecessor. In 1952 he commenced experimenting with a containerized method of shipping and storing household goods. Van Pak was organized to operate as a containerized freight forwarder of household goods. A forwarder assumes full responsibility to the shipper but purchases its transportation through a network of agents from common carriers.

On February 20, 1962 Van Pak commenced a public offering of 80,000 of its common shares at \$5.00 a share through registrant, as underwriter. Registrant sold the entire offering by April 18, 1962.

At the time of the offering substantially all of Van Pak's business was with the Government, forwarding the household goods of military personnel. In December 1961, Military Traffic Management Agency ("MTMA"), an instrumentality of the United States Government, had approved Van Pak's tender of service as a result of which it submitted its door-to-door tariff or rates to approximately 580 military installations within the continental United States and to overseas installations. A Department of Defense regulation provides that only those carriers will be used which furnish high quality service at lowest overall cost to the Government. Van Pak was in direct competition not only with van line movers, many having larger financial resources, but also with the MTMA. It is pertinent that the

Van Pak prospectus clearly states that Van Pak did not originate the containerized transportation method and that it is likely that others will use it.

Barrett testified that Van Pak had no contracts with the Defense Department, the State Department or any other government agency. He never told registrant that Van Pak anticipated government contracts. Van Pak had no guarantee of income as a result of its tender of service. While the registration was in preparation and thereafter, Van Pak furnished registrant with its financial data.

In February 1962, the lifting of a freeze on the movements of military dependents caused considerable optimism. Barrett addressed two meetings of registrant's personnel in March 1962. It is evident from the testimony of some of those present at the meetings that Barrett projected Van-Pak's earnings to between \$1 to \$1.50 per share. The pro forma statements prepared by Van Pak indicated substantial increases in net income for 1962 through 1964.

Prior to the offering Van Pak sought to register its shares in the State of Virginia. The Virginia authorities requested Van Pak ^{133/} to withdraw its application since Virginia law would deny effectiveness to the registration statement of an insolvent issuer and the financial statements in its prospectus disclosed that Van Pak was ^{134/} insolvent.

^{133/} Code of Virginia, Section 13.1-513(a)(5).

^{134/} Respondents urge that insolvency resulted from the Commission's insistence that Van Pak write off \$208,007 in development costs which it, theretofore, had carried on its books as an asset.

In April 1962, Hodgdon sold 3,000 shares of Van Pak to Mrs. A.S.W., a woman who had opened an account with him in 1959 and who recalls no instance in which she did not follow his recommendations. She testified that Hodgdon represented to her that Van Pak was a good investment; had a new type of container; had or would be obtaining government contracts and should therefore grow rapidly; would realize profits in a short time. and expected to start paying dividends. Nothing was said of Van Pak's financial condition. Hodgdon agrees this customer would be willing to take his recommendation. He states that he told the customer that this was a real flyer, a wild and wooly situation that held promise and he was quite high on it, but otherwise went into very little detail. The Hearing Examiner credits the customer's testimony. But even Hodgdon's testimony indicates his failure to advise A.S.W. of Van Pak's insolvent condition.

Haight sold 40 shares of Van Pak stock to Mrs. I.H. to whom he stated that when the price doubled she could sell half and regain her original investment. Haight told her nothing of Van Pak's financial condition.

Haight told E.W.C. who purchased 50 shares of Van Pak that the company had defense contracts and should have a bright future. He said nothing of the fact that the stock could not be sold in Virginia.

On Kitain's recommendation A.H.R., a financial planning client, bought 50 shares of Van Pak. A.H.R. was advised that the stock was a speculation. Kitain represented further, however, that the company had great prospects and that the president of Van Pak had told him that there were possibilities for getting a Defense Department contract.

To P.J.K., to whom Kitain sold 50 shares of Van Pak stock, he said the company was not making a profit but the stock had fine prospects of doubling itself in about 6 to 9 months.

C.A.P. and R.S.H. purchased 100 shares and 50 of Van Pak stock, respectively, but Kitain told neither of them anything of Van Pak's financial condition.

R.W.B. purchased 100 shares of Van Pak in February 1962 on Carr's recommendation before seeing the prospectus because of Carr's insistence that immediate action was urgent since very few shares were left. In fact, the issue was not sold out until April. Carr also represented to the customer that the company had developed a new type of shipping container, that there was a great demand for the product, that he was certain the stock would appreciate and make money, that it could double or better in 6 months. Carr said nothing about Van Pak's financial condition.

Carr sold 200 shares of Van Pak stock to L.E.C. to whom he represented that the stock was one of the most promising issues that

had come to his attention and that it couldn't miss. Carr did not disclose that the stock could not be sold in Virginia.

Carr failed to disclose any information regarding Van Pak's financial condition to G.C.C. or J.R.I., both purchasers of 100 shares of Van Pak. He did not advise J.R.I. that the stock could not be sold in Virginia.

C.A.S., a financial planning client, purchased 740 shares of Van Pak on Adam's recommendations in two transactions. Adam represented that Van Pak was about to get a contract with the Defense Department and that the stock had an excellent chance of appreciation in a short time. Adam did not tell the customer that the stock could not be sold in Virginia nor did he mention Van Pak's financial condition.

N.B. III purchased 100 shares of Van Pak through Kibler who represented that Van Pak had developed a new containerized method of shipment; that Van Pak had or expected contracts with the Defense Department and other government agencies; that in all probability the stock would increase a point or two by fall. H.S.Q. bought 200 shares of Van Pak after being told by Kibler that Van Pak was engaged, with government contracts, in overseas hauling of household goods in a new form of container. Kibler said nothing about Van Pak's financial condition or that the stock could not be sold in Virginia.

D.R.B. purchased 100 shares of Van Pak through Davis. Davis represented that this was going to be a terrific investment; that the customer could not afford to pass it up; that Van Pak had a new

process of storage or moving; that Van Pak expected to get substantial contracts that would materially increase the value of the stock and that it was likely to appreciate 2 or 3 or 4 times in a very short period. Davis said nothing about Van Pak's financial condition. M.McM., a financial planning client, purchased 50 shares of Van Pak on Davis' recommendation. She was told that Van Pak had a revolutionary new process of containerized moving and that Van Pak was going to have contracts with the Government. Davis also sold 100 shares of Van Pak to M.B. He said he had a rather hot item in Van Pak; that Van Pak had a relatively new item, a steel container; that they expected to make \$250,000 in the forthcoming year. M.B. asked for a prospectus but Davis advised he was out of them. When the customer said he would wait, Davis urged immediate action saying that if he didn't take it then it would no longer be available.

Harper represented to C.J.M., a financial planning client to whom he sold 100 shares of Van Pak, that she might be able to sell the stock at a much higher price and get a high return.

Harper told A.K.D., to whom he sold 100 shares, that Van Pak had a new method of moving. He said nothing of Van Pak's financial condition.

Roper represented to R.C.S. that Van Pak was going into a new phase of containerized freight and failed to disclose that Van Pak could not be sold in Virginia. He told H.H.H., who bought fifty shares of Van Pak, that the company had a new concept in packing

household goods and they ought to make money on it. Roper did not advise H.H.H. that Van Pak stock could not be sold in Virginia.

Flynn represented to O.L. that Van Pak had an entirely new concept in containerized shipping and that it might double in a year and one-half or two years. Flynn stressed that the available stock was limited because folks were buying it in large blocks and urged the customer to quick action. He also stated that growth potential of the stock was good because of the government contracts they expected.

Schultz sold J.E.C. 50 shares of Van Pak but omitted to inform the purchaser of the Van Pak's financial condition.

Roley, a registered representative, omitted to advise J.I.S., to whom he sold 100 shares, that Van Pak stock could not be sold in Virginia. He told L.K.H., to whom he sold 100 shares, that an officer of registrant had said that at the end of the year the stock would be more valuable than any one they could choose. He neglected to say that the stock could not be sold in Virginia.

Allan Altschull, a registered representative, sold T.P. 40 shares of Van Pak stock after representing to her that Van Pak was expecting to get defense contracts. He said nothing regarding Van Pak's financial condition or that the stock could not be sold in Virginia.

Luttrell sold E.N.H. 400 shares of Van Pak stock after stating they had plans for big contracts with the Government. Nothing was said about the company's inability to sell its stock in Virginia.

The predictions of profits and price rises had no reasonable ^{135/} basis in fact. The Commission has held repeatedly that predictions of substantial increases in the price of speculative securities within short periods of time cannot be justified and are inherently ^{136/} fraudulent. The representations as to the existence or anticipation of contracts with the government or its agencies were clearly false and fraudulent. ^{137/} The representations that Van Pak had a new or revolutionary type of container, or a new concept, or a new containerized method of shipment or a new process were equally misleading. ^{138/} Additional representations including "hot item," expectation of dividends, the need for immediate action by customer when the issue was selling slowly, "can't miss," and "can't afford to pass it up" were patently false. Further, respondents' failure to inform customers of Van Pak's insolvency and of the refusal of the State of Virginia to accept its registration (which obviated the need to explain the reason for the refusal) were contrary to registrant's obligation of fair dealing. ^{139 & 140/}

^{135/} Shearson, Hamill & Co., Securities Exchange Act Release No. 7743 (November 12, 1965).

^{136/} Norman Pollisky, Securities Exchange Act Release No. 8381 (August 13, 1968).

^{137/} Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962).

^{138/} R. Baruch and Company, Securities Act Release No. 7932 (August 9, 1966).

^{139 & 140/} Martin A. Fleishman, *supra*.

Respondent's arguments in justification of their activities in the sale of Van Pak stock have been considered and found wanting. The "bullish feeling" which respondents contend was justified by favorable reports from issuer hardly warrants predictions of price rises which, even if stated as opinion, bear the hallmark of fraud.^{141/} The contentions that witnesses might have transmuted Van Pak's actual relationship with the government to "government contracts" cannot stand in the face of the testimony of at least ten witnesses that representations of existing or anticipated government contracts were made. Respondents' assertion that the salesman's various statements representing that Van Pak had a new and revolutionary process or method of shipment were merely innocuous claims that Van Pak was doing something different has little merit. Such representations present to the investor prospects of profits to be derived from the advantage to be gained, at least temporarily, from a virtual monopoly.

^{141/} Alexander Reid & Co., Inc., 40 S.E.C. 986 (1962).

Apache Canadian Gas and Oil Program 1961

Commencing in August 1961, registrant participated in the offering of Apache Canadian Gas and Oil Program 1961 ("Apache Canadian") at the price of \$5,000 per unit. The proceeds of the offering were to be used for the exploration and development of Canadian gas and oil leaseholds. The cover page of the prospectus stated that each unit is subject to completion costs which cannot exceed \$2,500. Elsewhere in the prospectus it was indicated that if any well drilled has encountered reserves of gas and oil in commercial quantities, Apache Corporation ("Apache") will impose additional assessments.

In September 1961 Harper sold a unit of Apache Canadian to A.K.D., a financial planning client. A.K.D. was entirely inexperienced ^{142/} in the securities field and relied upon Harper completely.

Apache advised registrant and the latter informed its salesmen of Apache's policy that investors who assume the risks inherent in gas and oil exploration should be in the 48% tax bracket and in a position to sustain that bracket, prospectively, for at least five years. Harper was aware of this policy which registrant adopted. He had no reason to assume that A.K.D. could qualify. His belief that extensive capital gains over a period of two years might place her in the 48% bracket for those years does not meet the policy. Harper's statement that he told A.K.D. about the 48% tax bracket at the time of her purchase of the oil program (albeit, without adding the need for sustaining that bracket for at least 5 years) is not credited. But

^{142/} "What he recommended, I bought."

even if accepted, it would not justify his recommendation in the face of A.K.D.'s inexperience and reliance upon him.

Harper told A.K.D. that the investment would really grow into something profitable and that the tax benefits inherent in the investment would affect, at least in part, the customers' capital gains arising out of the sale of securities.

It is readily apparent from A.K.D.'s correspondence with Harper, even apart from her testimony as to conversations with him, that she was informed only of the initial \$5,000 cost of the unit. Harper did not advise her of either the \$2,500 assessment for completion costs to each unit or the additional assessments which might be made, as set forth in the prospectus. Harper's assertion that the additional assessments^{143/} came as a surprise to him and caused him to protest the assessments is not supported by the record which contains only references to communications with the issuer relating to the Harper's mistaken impression that Apache would handle financing of investors' assessments beyond the \$7,500 figure.

Some few months after her purchase of the program, A.K.D. indicated to Harper her displeasure with the investment and its continuing obligations and commenced a series of requests that it be sold. On various occasions, however, Harper assured her that it would be a mistake to get out; that she was lucky to be in it; that he knew of several anxious buyers; that it had a fine potential and over a period of years she could ultimately realize \$125,000 or as much as \$250,000.

^{143/} A.K.D.'s investment in this program increased to about \$15,000 by 1964 due to additional assessments.

In addition, in periodic written analyses of A.K.D.'s portfolio Harper ascribed various values to the unit and commented on its future potential. On February 8, 1962, he used "\$7,500^{144/}," the amount representing the actual cost of the program, "until a full evaluation is completed." He noted, however, that "Bids have run as high as \$25,000 per unit. This may be considered under evaluation." The value figure in his analysis of January 8, 1963 is not decipherable. But he stated there: "Also, the estimated income should run as much as \$40,000 within the next 15 - 20 years." The analysis of August 4, 1964 carried a value of \$24,120 and later Harper increased that sum to \$35,000.

Some time in February or March 1962, Harper told C.E.B., another of his financial planning clients, that Apache Canadian looked like one of the best programs Apache ever had, but that it was too late to acquire one in the usual way since they were no longer available from Apache.^{144/} This was merely a prelude to his recommendation that C.E.B. purchase a unit of Apache Canadian from Roper who was now offering for sale a unit he had previously acquired. Harper arranged the sale from Roper to C.E.B. for the sum of \$12,050.00,^{145/} on which Roper made a profit of \$5,000.

At the time, in 1962, when he recommended the program so

^{144/} C.E.B. was not in the 48% tax bracket. Harper testified that C.E.B. was reluctant to reveal his income for some time and that he didn't know about C.E.B.'s bracket.

^{145/} It would appear, despite a document entitled "Sale and Trust Agreement dated January 1, 1962," that the sale did not occur until December 1962 and the earlier document was prepared to assure that C.E.B. would be entitled to tax benefits accruing from ownership of the unit during the year 1962. Thus, a letter from Roper to C.E.B. dated December 12, 1962 refers to C.E.B.'s "option to buy" the program and Harper's review of C.E.B.'s portfolio in August 1962 makes no mention of the unit. C.E.B.'s total payments in December 1962 were \$15,250, of which Roper received \$12,050, the balance representing additional assessments.

highly to C.E.B., Harper was hardly in a position to have sufficient concrete information to warrant his representation. The program had been offered on August 21, 1961. In his evaluation of the program for A.K.D. on February 8, 1962, Harper used merely cost plus as value because it was too early to make an evaluation.

In July 1962, Apache advised Roper, by letter, that it offered him the sum of \$9,700 for the unit, assuming the most recent assessment had been paid, which would bring total payments up to \$9,500.^{146/} Without regard to the ambiguous testimony by C.E.B. as to whether he was informed of Apache's bid, Harper must have seen Apache's letter before the transaction was completed despite his testimony, first denying it and later expressing uncertainty. Whether, in view of the various discount factors applied by Apache, the bid was indicative of the value of Roper's unit is not controlling. Inasmuch as it was the only bid for Roper's interest, Harper should have given it some consideration in evaluating his recommendation to C.E.B. which brought Roper a 40% profit on his investment. Even without the discount factors, but predicated on the fact that Roper had not paid the most recent assessment of \$2,500, Apache's valuation would fall far short of the \$12,050 paid by C.E.B.

In Harper's various analyses of C.E.B.'s property and portfolio and in other correspondence, Harper valued C.E.B.'s Apache's Canadian program on January 3, 1963 at \$22,000; on February 24, 1964 at \$30,000; and on February 27, 1964 he advised C.E.B. that according to the president of Apache it had a possible worth of \$100,000.

^{146/} Apache's bid is predicated upon a discount of 5% plus a second discount of 20% "for risk and profit." Apache reserved a right of first refusal to purchase investors' interests.

A vice president of Apache Corporation testified there was no basis for the valuation of \$22,000 as of June 1963 or of \$30,000 and \$100,000 as of February 1964. In a letter from Apache to Harper and Richardson dated May 7, 1964, Apache gave an admittedly ultra-conservative evaluation of \$7,054.00 to the Canadian Apache Program.

Harper asserts he obtained the valuation figures, income projections and other data appearing in his analyses of A.K.D.'s and C.E.B.'s accounts from Apache. Some of the documents on which Harper relies to support representations of value are program reports by Apache to participants, none of which contain any estimate of value. Other Apache reports contain estimates of "ultimate gross income" which, of course, is not commensurate with current value. All the reports are replete with caveats. Harper points, in addition, to Apache's letter of December 11, 1962, which refers to an expectation of "a future income in excess of \$20,000" and continues:

"Were one to sell a unit at the present time I would think the investor would hope to realize \$15,000 to \$20,000 from it. A liquidating figure would be somewhat less than this figure."

But the letter is self-defeating for Harper's purposes. "Future income" is too indefinite as to time to warrant a plausible estimate of current value of an amount equal or nearly equal to that ascribed to future income, especially where income is the sine qua non of value. Harper should not have relied on it.

Harper also places reliance on an undated typewritten bid directed to Haight in the amount of \$15,000 for his unit. The figures

"6/62" appear in ink at the top of the letter. Harper states the date is in his handwriting and that he saw the document in the middle of June 1962. But he cannot recall when he wrote the date. Since he must have had a special reason for inserting the date, his failure to recall when he wrote it is discredited as is the existence of the letter at that time.

In any event neither of the aforesaid letters would justify, as fair and reasonable, his recommendation in February or March 1962 that C.E.B. purchase this unit at \$5,000 over Roper's cost.

The Hearing Examiner credits Harper's testimony of July 1965, taken during the course of the investigation, that he is sure he told Hodgdon, Haight and Carr of the Roper-C.E.B. transaction as against his testimony at the hearing that he can't be certain that he mentioned it to anyone at registrant.

Harper's activities in respect of the sale of Canadian Apache to these two clients and his representations to them thereafter in respect of the value and future realizations from that security presents a reckless disregard of his duty and responsibility of fair dealing.^{147/} To recapitulate briefly, he put A.K.D. into the security despite her inadequate tax bracket. He did not know whether C.E.B. qualified in that respect. His recommendation that C.E.B. purchase Roper's shares at a price \$5,000 in excess of Roper's investment without any reliable evidence of its value constituted a palpable fraud on C.E.B. for Roper's benefit. He failed to advise A.K.D., a particularly unsophisticated investor, of her additional financial obligations under the program over and above its initial cost. The testimony of Apache's vice president discredits any reasonable basis for Harper's predications of ultimate realizations of \$125,000 to \$250,000 to A.K.D. and \$100,000 to C.E.B. and for the various valuations he assigned to the program in his analyses to both clients.

Roseville-Detroit Limited Partnership

The Roseville-Detroit Limited Partnership (Roseville-Detroit) was organized in December 1963 by Hodgdon and Baskin, as general partners and promoters, to acquire title to a department store property in Roseville, Michigan. Limited partnership interests were offered to the public pursuant to full registration at \$1,000 per unit commencing March 2, 1964. Registrant was the underwriter.

^{147/} J.A. Winston & Co., Inc., Securities Exchange Act Release No. 7337 (June 8, 1964).

The initial registration statement filed with the Commission stated the intention "to provide for a return to the Limited Partners equal to 9% of their cash capital contribution." Thereafter, a letter of comment by the Commission's Division of Corporation Finance pointed out that "inasmuch as distributions made to the Limited Partners will represent both investment income and a return of capital, the references to a 9% return on capital contributions should be deleted to avoid statements which seriously overstate the true rate of return on the proposed investment." The letter also suggested that the prospectus point out that, based on tabular presentations in the registration statement, "the true rate of return on invested capital is approximately 4% for the first year."

Although Hodgdon, Baskin and their counsel disagreed with the comment set forth above, the initial prospectus was revised and that issued on March 2, 1964 stated that \$40 of the first year's distribution of \$90 "will be a taxable return on investment (representing a 4% return on invested capital during the first year), while \$50 will represent tax-free return of capital (generated from the excess of the provision for depreciation of fixed assets over amortization of mortgage principal)". The prospectus also disclosed that upon the completion of the offering no market will be established for the limited partnership interests and that no broker-dealer activity or market can be expected to develop other than isolated brokerage transactions effected through registrant.

Sales meetings of registered representatives at which the Roseville-Detroit offering was discussed were addressed by Hodgdon,

Haight and Baskin. The registered representatives were informed that the return or income or yield would be either \$90 or 9% or both. A summary of information in respect of the Roseville - Detroit offering entitled GEM STORE - DETROIT, MICHIGAN was distributed to the salesmen. The summary contained the following statement:

"WHAT YOU GET - (1) Income @ 9% payable quarterly."

Haight sold to G.M.B., a financial planning client 5 units of Roseville-Detroit. G.M.B. testified Haight said she would receive a high rate of return of 7 to 8% or 7 to 9% and a tax shelter. Haight testified he told G.M.B. the expected payout was 9% or \$90 per unit or both.

B.B.N. purchased 5 units through Kitain. He testified Kitain said that the rate of return would be about 9% of which 50% would be non-taxable. Kitain says he told B.B.N. that the distribution would be at least \$90 per unit. In either case B.B.N. was not told that the distribution on his investment would be, in part, a return of capital. B.B.N. considered the distributions received from his investment the same as a dividend from General Motors stock.

J.R.W., Jr. bought one unit of Roseville-Detroit on Harper's recommendation. Harper informed him that Roseville-Detroit had an income provision of approximately 9%. Nothing was said about marketability or tax advantages. J.R.W. was not informed that part of the funds he received would be a return of capital.

R.W.B. purchased two Roseville-Detroit units through Kibler who said he would receive a 9% return on his investment and more.

Kibler testified, he stated, in addition, that the customer could anticipate the return would be tax-sheltered and had explained the meaning of the term to R.W.B. on earlier occasions.

In letters by Adam to G.Y.G., a financial planning client, and to two other customers relating to the Roseville-Detroit offering, Adam stated, variously, that it "yields 9% with about one-half of it tax sheltered" and "we get a 9% return".

Resnick told M.I.B., who bought one Roseville-Detroit unit, that there was a guaranteed 9% return and it had income tax shelter.

John F. Saffer, Jr. wrote to three customers describing the Roseville-Detroit offering and in each letter he stated: "This investment is designed to return 9%, part of which is tax sheltered."

As one of the general partners of Roseville-Detroit, Baskin was directly interested in assuring completion of the distribution of the issue. Baskin attended registrant's sales meetings at which the Roseville-Detroit underwriting was discussed and agreed he addressed those meetings once or twice. Regardless of whether he, Hodgdon or Haight actually informed the salesmen that the rate of return on a Roseville-Detroit unit would be \$90.00 or 9%, or whether Baskin actually furnished the information from which the memorandum distributed to salesmen stating "Income @9% payable quarterly" was prepared, he was present at the meeting and must have been aware of the memorandum.

Baskin asserts that the only allegation charged against him "singly" is not supported by the record. The allegation is found in subparagraph IIB(12) of the order for proceeding which asserts, in substance, a failure of supervision. Baskin's position has merit. He did not function as a vice president or director.^{148/} His position as assistant to the president required him to do, in effect, whatever Hodgdon asked him to do. The record does not establish that this included any supervisory duties other than to review correspondence after it had been forwarded, from the end of 1963 to early 1964.^{149/}

But Baskin is also charged by the order for proceedings with acting "in concert" with other respondents in the making of untrue and misleading statements of material fact and in omitting to state material facts regarding the rate of return on the Roseville-Detroit securities. He was present when oral statements were made to registrant's representatives as to the rate of return. He knew of the written material distributed to registrant's salesmen and he knew that both the oral and written material were intended for repetition by the salesmen to prospective purchasers. He knew that the registrant's predictions as to return and income were in direct contradiction of the letter of comment by the Division of Corporation Finance with which he disagreed, but which was followed in Roseville-Detroit's final registration statement. These factors constrain the conclusion that he acted, in participation with the others responsible, in a scheme to defraud.^{150/}

^{148/} Division's reply brief states "no objection" to Baskin's proposed findings to that effect.

^{149/} Cf. Schmidt, Sharp, McCabe & Company, Incorporated, Securities Exchange Act Release No. 7690 (August 30, 1965).

^{150/} Billings Associates, Inc., Securities Exchange Act Release No. 8217 (December 28, 1967), p. 5.

Baskin urges that the existence of an agreement is essential to establish a scheme to defraud. He concedes that "the 'agreement' can either be expressed, or inferred from the conduct of the parties charged," but contends that even such an agreement is absent here. It is too plain to require extended discussion that, even granting that Baskin neither made the oral statements referred to above nor prepared the summary distributed to salesmen, his knowledge of both, without protest, demonstrate his tacit approval from which his agreement to these activities may properly be inferred. " * * * [P]articipation in a scheme may be shown from the surrounding circumstances if they should have alerted the persons to the existence of such scheme." 151/

Baskin contends, further, that even if 9% were represented as the true rate of return it would not be a misrepresentation; that neither 4% nor 9% may be characterized as a rate of return; that as a sound economic fact, it is impossible to ascertain the "true" rate of return until the property has been sold because depreciation allowances taken by the owners of real property do not represent the actual degree to which the property may have depreciated. He argues that Division's position that "taxable return" and "true return" are equivalent is untenable, pointing to the provisions for "recapture" in the Internal Revenue Code which provide for upward adjustment of underestimated taxable returns reported in previous periods.

151/ Billings Associates, Inc.; supra.

But even the acceptance, arguendo, of these "economic realities" would not aid Baskin's case. Rather, they would mark as premature, without reasonable basis in fact and, therefore, as misrepresentation, the 9% return which registrant represented to its salesmen at the Roseville-Detroit sales meeting. Moreover, Baskin completely overlooks the reference to "Income at 9% * * *" in the memorandum distributed to salesmen. Certainly "income" cannot be said to denote any of the concepts Baskin would attribute to "return". 152/

152/ At the close of Division's case Baskin moved to dismiss the order for proceedings as to him. The Hearing Examiner reserved decision since, under Rule 11(e) of the Commission's Rules of Practice, a ruling by a Hearing Examiner which disposes of all or part of a proceeding may be made only in his initial decision. The motion is denied.

The representations set forth above in respect of the offer and sale of units of Roseville-Detroit constituted violations of the anti-fraud statutes of the securities laws. Full disclosure would have required that customers be informed not only of the anticipated 9% or \$90 distribution, but also that, as indicated in the prospectus, \$40 thereof would represent taxable income on the investment and, as an adverse factor which might affect the customer's investment decision,^{153/} that the balance of \$50 would constitute a return of capital. The statement by Kitain to his customer that 50% of the return would be non-taxable is hardly adequate. Moreover, the fact that some of these customers may have received prospectuses^{154/} does not cure the misrepresentation. Further, they had no conception of the meaning of the tax-free return of capital referred to in the prospectus, of which their salesmen were aware. The lack of understanding on the part of G.M.B., Haight's client, has been demonstrated above. She understood tax shelter to mean she paid less taxes. G.Y.G., Adam's client, had, in Adam's words, "complete lack of knowledge of investments." M.I.B. was a completely unsophisticated investor. B.B.N., Kitain's client, considered his distributions from Roseville-Detroit the same as dividends from General Motors. The testimony of R.W.B., Kibler's client, displays utter confusion. Harper's representations of anticipated income of 9% to J.R.W. needs no further comment. In view of the background of the ultimate language in the prospectus, registrant's statement predicting income at 9% in its written summary was flagrantly fraudulent.

^{153/} Cf. Charles P. Lawrence, supra; Richard J. Buck & Co., Securities Exchange Release No. 8482 (December 31, 1968).

^{154/} J.F. Howell & Co., Inc., Securities Exchange Act Release No. 8087 (June 1, 1967) p. 4.

It has been found above that Baskin participated "with the others responsible" in a scheme to defraud in the offer and sale of the Roseville-Detroit security. Hodgdon and Haight had the same knowledge ascribed to Baskin in reaching that determination and are "the others responsible" for the scheme to defraud.

It is concluded, therefore, that Section 17(a) of the Securities Act, Sections 10(b) and 15(c)(1) of the Exchange Act, and Rules 10b-5 and 15c1-2 thereunder, were wilfully violated by the registrant in the offer and sale of all the securities set forth below and by the individual respondents in the offer and sale of the securities indicated below as pertaining to them, and said individual respondents aided and abetted registrant's wilful violations of the aforesaid sections and rules.

As to USI; Amann and Kitain.

As to Paragon; Carr.

As to DPCA: Amann, Kitain and Davis.

As to Van Pak: Hodgdon, Haight, Kitain, Carr, Adam, Kibler, Davis and Harper.

As to Apache Canadian; Harper.

As to Roseville-Detroit; Haight, Kitain, Harper, Kibler, Adam and Baskin.

Further, for the reasons set forth above, Hodgdon is found to have wilfully violated the aforesaid sections and rules in the offer and sale of all of the aforesaid issues except DPCA, by virtue of his position and responsibilities in connection with the management of registrant. Registrant, Haight and Carr wilfully violated Section 15(b)(5)(E) of the Exchange Act in failing to reasonably discharge their supervisory duties. Carr, however, is not responsible as to DPCA.

II. Books and Records - Failure to send Confirmations

Van Pak

Upon learning that the stock of Van Pak could not be registered in Virginia, Hodgdon announced to registrant's salesmen that counsel had advised that sales to Virginia residents were unobjectionable if made outside of that state; that, if possible, it would be preferable to use a legitimate address of the customer outside of Virginia to which to mail confirmations; that if the sale was not made in Virginia the confirmation must be marked ^{155/} "unsolicited." Hodgdon stated that he knew registrant could not solicit "on a large concerted scale" in a state in which the security was not registered. Although he did not define a "legitimate address," he advised the registered representatives that they could solicit at business addresses of prospective purchasers outside of Virginia. Apparently, he considered federal installations as "outside of Virginia," even if located in Virginia.

Registrant's order clerk testified that during the Van Pak distribution the trading department was instructed that confirmations directed to Virginia residents were to be marked as unsolicited orders. Since even the order tickets of salesmen who testified they were not aware of the problem contained the "unsolicited" notation, the instruction must have been construed to include order tickets.

- 155/ Several different terms or words were used in marking order tickets and confirmations to denote that the order had not been solicited. For simplification, the term "unsolicited" will be used to represent all these variations.

Respondents contend that the term "unsolicited" was intended to mean not solicited in the State of Virginia. But this interpretation is inconsistent with Hodgdon's preference that an address outside of Virginia be used for confirmations. Under respondents' professed understanding of the meaning of the term, that device would have been entirely superfluous.^{156/} Moreover, the record contains instances in which Virginia residents were actually solicited in Virginia, yet their confirmations were marked "unsolicited."^{157/}

Since the record does not establish that the order tickets were marked "unsolicited" by the salesmen,^{158/} they cannot be said to have aided and abetted in the making of false entries in registrant's records. Having instructed the registered representatives and the trading department as to the procedure to be followed, Hodgdon shares responsibility with registrant for the fictitious entries.

Amann and Kitain sold shares of USI, which they had purchased, to a Mr. C. and to A.H.R., respectively. Both were clients of registrant.^{159/} A.H.R. made his check payable to Kitain because

^{156/} This was not the first time the registrant faced this problem. In connection with the Watson distribution in which registrant was underwriter, confirmations of sales to some Virginia residents were forwarded to the office of an attorney in Washington, D.C. The practice ceased when he protested.

^{157/} It is unnecessary to discuss the propriety of registrant's assumption that solicitation of Virginia residents made outside of Virginia was proper.

^{158/} Except Carr who marked an order which was, in fact, unsolicited.

^{159/} C. did not testify.

Kitain asked that it be done that way. Amann testified C. was one of the persons who bought "behind me". A.P.S., who purchased the convertible debenture, thought he was dealing with registrant but acceded to the request of Amann, an officer of registrant, to make the check payable to USI and send it to registrant, to Amann's attention. None of these transactions passed through registrant's books. None of these customers received a confirmation. It does not appear that at least A.H.R. and A.K.S. had reason to believe they were not dealing with registrant.

Kitain sold DPCA shares to one of his customers and Davis to four. All were clients of registrant. Registrant's stationery and facilities were used by the salesmen in effecting these transactions. The customers did not receive confirmations.

These circumstances, compel the finding that the aforesaid transactions in the stock of USI and DPCA were effected by registrant.^{160/}

Accordingly, it is concluded that registrant, aided and abetted by Hodgdon wilfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder; and that registrant, aided and abetted by Amann, Kitain, and Davis, wilfully violated Section 15(c)(1) of the Exchange Act and Rule 15c1-4 thereunder.

^{160/} Cf. R.D. Bayly & Company, 19 S.E.C. 773, 786 (1945).

III. Failure to Amend B-D Application

During the relevant period registrant failed to file amendments to its application as a broker-dealer reflecting Amann's election as a vice president in February 1960 and as director in March 1960, Luttrell's election as executive vice president and director in late 1960 and Louis E. Shonette Jr's election as a vice president and director in May 1962. Respondents urge that the function of preparing such amendments was delegated to Hodgdon's secretary. Neither that delegation nor the fact that the registrant's minute books reflect these changes either excuse the violation or refute "wilfulness". Obviously, if Hodgdon delegated the function, he was aware of the necessity for its proper performance and assumed the responsibility therefor. Any other interpretation would, in effect, nullify the rule.

Accordingly it is concluded that registrant, aided and abetted by Hodgdon, willfully violated Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder.

Division seeks to charge Haight, Carr and Amann with the same violation presumably on the theory that each of them was an officer of registrant at the time one of the changes in officers and directors, set forth above, occurred. Since these respondents had no responsibility in this area,^{161/} the allegation is dismissed as to them.

^{161/} Schmidt, Sharp, McCabe & Company, Incorporated, Securities Exchange Act Release No. 7690 (August 30, 1965), Midwest Planned Investment, Inc., Securities Exchange Act Release No. 7564 (March 26, 1965).

IV. Failure To Transmit Funds Promptly

Registrant, as underwriter, engaged in the sale of Southeastern Mortgage Investment Trust shares. The record shows substantial delays in the transmission to the issuer of funds registrant received from the sale of these shares in respect of over 170 transactions during January and February 1964. Most transmissions were made within 6 to 10 days after receipt of the funds. Some delays were within the 11 to 22 day range. Registrant admits it failed to place the funds in escrow as required. 162/

Registrant's cashier was responsible for the transmission of funds received on shares sold pursuant to an underwriting. His general practice had been to transmit such funds within 48 to 72 hours after settlement of the transactions. It appears, however, that during the period when the transmission of funds was delayed, registrant was in the midst of converting its accounting system and the cashier was running two parallel operations and was deluged with work. Everything he did in his own installation had to be repeated for the new equipment or service.

Registrant's practice of transmitting funds in 48 to 72 hours in other underwritings is a ready indication that it must have known it held the fund's overlong. Any reasonable construction of the term "promptly" would require a finding that the rule was violated.

162/ Rule 15c2-4 under the Exchange Act.

It is concluded therefore that registrant wilfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.

Public Interest

In July 1964 (directly following the end of the relevant period) Hodgdon's stock ownership in registrant was substantially reduced by registrant's acquisition of part of his holdings and he ceased participation in day to day management. His remaining stock, between 30-40%, was redeemed by registrant in December 1965. As of the close of the hearings he was no longer engaged in the securities business. When Hodgdon left management in July 1964, Haight became president and owner of about 35% of registrant's stock; Carr owned over 10% of registrant's stock and was elected a vice president; *and 15% stockholder; Harper became a vice president* Kitain became a vice president, ^{163/} and 8% stockholder and Adam became a vice president and stockholder.

Division urges that public investors should no longer be endangered by these respondents and recommends that the broker-dealer registration of registrant be revoked and that all individual respondents be barred from association with any broker or dealer.

Various factors have been urged by the respondents ^{164/} in mitigation as warranting the imposition of no sanction. Due to the adverse

^{163/} These figures are furnished by respondents' proposed findings.

^{164/} These include all respondents except Amann and Baskin. Until they are specifically named, Amann and Baskin are not referred to in this portion of the initial decision.

publicity stemming from the institution of these proceedings registrant has suffered damage to its reputation, loss of personnel and a severe decline in its business. The defense of this proceeding has involved great expense. Since July 1964 registrant has altered its policies and practices. It does not engage in private placements. Its listed business has increased to 58% of its sources of income. Registrant no longer underwrites real estate limited partnerships or small speculative industrial enterprises. As of 1966 participation as an underwriter or selling group member represented about 5% of its gross volume. Securities research is now provided by member firms of the NYSE. Further, registrant has imposed more stringent controls over its personnel, has taken other steps to assure adequate supervision of customers' accounts, adherence to financial plans and no excessive activity or large commitments in speculative securities. It has installed a system for monitoring telephone calls, permits no discretionary accounts except under extraordinary circumstances and has employed an attorney on a full time basis whose functions relate to regulatory matters and to assist Haight in the supervision of sales activities. Haight now devotes 80% of his time to managerial duties.

Hodgdon was the architect of registrant's operations. He selected all its underwritings and the securities in which it traded. He prepared its advertising and radio broadcast material. His methods sought and achieved the relationship of trust and confidence with registrant's clients and his complete indifference

to supervision led to the abuse of that relationship. He allowed registrant to proceed with the USI offering despite his own poor opinion of it. He permitted the distribution of false memoranda on Paragon and Roseville-Detroit to salesmen. He furnished his salesmen the unjustified rate of return predictions on the real estate syndication units. The entire record of this proceeding discloses that he gave mere lip service to the benefits of financial planning. Hodgdon should be barred from association with any broker or dealer.

In imposing sanctions as to the remaining individual respondents the Hearing Examiner has considered, in addition to the foregoing mitigative factors, that they were under the direction of Hodgdon who was in sole control of registrant, that, with the exception of Haight, their employment by registrant was their first association as registered representatives qualified to sell securities with a broker-dealer. No prior disciplinary proceedings have been instituted against any of them or against Haight. The Hearing Examiner has also considered that during the relevant period, the sale of real estate limited partnerships was a relatively new field of activity in the securities business. Absent these considerations and the extensive changes made by registrant's new management, which are designed to more closely control their activities, the misconduct of virtually all these respondents would require a permanent bar. This does not mean, however, that all can escape permanent bar or that those that do so can escape without severe sanctions. The offenses were too grave.

Haight's culpability is too serious and extensive to warrant less than permanent bar. Haight was employed by a broker-dealer for about two years before joining registrant. Despite Hodgdon's control, Haight, as vice president in charge of sales, had direct responsibility for supervision and failed to properly supervise registrant's salesmen. He must have acquiesced in Hodgdon's obviously deliberate inertia in that direction which led, among other things, to the loading of customers' accounts with securities from which registrant and its salesmen gained most and in which Haight and all these respondents participated. Haight and each of them, except Carr, also misrepresented anticipated returns from real estate syndication units which could not be supported by the prospectuses.^{165/} They should not have relied blindly on Hodgdon's rate of return.^{166/} Moreover, the record discloses that Haight's activities included conspicuous mistreatment of financial planning customers' accounts in other respects, improper conduct in respect of the sale of Van Pak shares and participation in the dissemination by registrant of improper information to its salesmen in connection with the Roseville-Detroit offering, with knowledge of the exchange of letters between registrant and the Division of Corporation Finance.^{167/}

^{165/} "[T]he information in a prospectus furnishes a background against which a registrant and its salesmen can test the representations they are making, and those who sell securities by means of representations inconsistent with the information in the prospectus 'do so at their peril'." J.F. Howell & Co., Inc., supra.

^{166/} Walker v. S.E.C., 383 F.2d 344 (C.A. 2, 1962).

^{167/} Registrant's salesmen were not told of these letters.

Haight should be barred from association with any broker or dealer.

Carr's culpability is not as great. His responsibility for failure of supervision of registrant's salesmen stems from his position as senior vice president, his regular attendance at meetings, his constant availability to registered representatives for consultation and the general knowledge of registrant's operations which must be imputed to him, rather than from the assignment of a particular function. Nevertheless, he should have been aware of and is answerable for registrant's improper operations. Carr had no direct involvement with the sale of real estate syndications. However, like the others, he caused his financial planning customers to purchase too much of registrant's underwritings and trading securities. He also made misrepresentations in the sale of Paragon and Van Pak stock. Carr should be suspended from association with any broker or dealer for ten months.

Kitain furnished misleading and improper advice and is chargeable with various other improprieties in his treatment of the accounts of his financial planning customers over and above "loading" and real estate "return" misrepresentations. Moreover, he has demonstrated a propensity for ignoring registrant's policies and instructions in respect of the investment of the proceeds of insurance policies, the

use of a client's account for his own transactions and the sale of DPCA stock. The mutual fund "breakpoint" transactions were highly improper. His sale of USI and Van Pak stock were accompanied by misrepresentations.

Kitain should be suspended from association with any broker or dealer for one year.

Davis' misguided assurances to his financial planning client that Hodgdon would be behind everything exceeded the bounds of fair dealing. He also "loaded" clients' accounts and misrepresented real estate returns. His advice to the client to disregard prospectuses and his unjustified comparison to the unsophisticated investor of interest payable on a loan with the distributions to be received from real estate syndication investments were unconscionable, as were his extravagant predictions in respect of Van Pak and its stock.

Davis should be suspended from association with any broker or dealer for one year.

Kibler's financial planning accounts were "loaded" and he misrepresented real estate returns. The record shows no other misconduct in respect of these clients. But he also made serious misrepresentations in the sale of Van Pak stock. He should be barred from association with any broker or dealer for five months.

Adam's and Harper's flagrant abuse of the confidence of their unsophisticated financial planning clients, who trusted them completely, was so grossly reprehensible as to warrant a permanent bar despite the mitigative considerations set forth above. Adam's handling of

two financial planning accounts constitute a reckless disregard of his obligations to his clients. He ignored his own financial plan, he recommended highly speculative securities despite his client's insistence on safety in investments. His reports to his clients were false and misleading in eliminating losses and in representing real estate syndication distributions as income. He presented great exaggerations of prospective profits. He falsely represented the value of securities he recommended and gave contradictory recommendations to two clients regarding the same security. He also made fraudulent representations and omissions regarding the securities of Van Pak.

Harper's assurances of expertise and devotion to their interests to two of his clients, in order to obtain their confidence, were magnified far beyond reasonable bounds. He estimated monumentally extravagant profits shortly after an account was opened. He ignored his own financial plan. He purchased highly speculative securities in complete disregard of his clients' pleas for safety and made highly excessive and unreasonable projections of future income. He falsely predicted appreciation of real estate syndication investments and represented distributions from such syndications as income. In addition, he made fraudulent representations in the sale of Lord of the Flies and Van Pak and excessive predictions as to future value of Canadian Apache. He caused a client to purchase a unit of Canadian

Apache from a fellow salesman at an exorbitant profit to the latter. He misrepresented the distribution expected from Roseville-Detroit as "income". Adam and Harper should be barred from any association with a broker or dealer.

Amann shares chief responsibility with registrant for the sale of the unregistered securities of USI and is mainly responsible for the violation of the registration requirements in respect of DPCA. Since Amann was advised by counsel, at the time of the USI offering, that "no longer is the twenty-five person rule of thumb sacrosanct", he is deemed to have proceeded with both the USI and DPCA offerings in deliberate violation of the statute. Moreover, Amann has exhibited a proclivity for the involvement of himself and his clients in highly speculative promotions and, as his brief admits, without adequate investigation. His use of his position with registrant in connection with the third offering of USI and the DPCA offering constituted a misrepresentation that registrant sponsored those offerings. His association with the DPCA offering came after he had already been upbraided by registrant for the USI promotion. Further, he made serious misrepresentations and omissions in the sale of the stock of USI, DPCA and Van Pak.

Amann urges that he has suffered enough through adverse publicity, that he has never before been the subject of any disciplinary proceeding, that he believed in the merits of USI and DPCA offerings and

invested his personal and family funds in them. However, Amann had been in the securities business both as a registered representative and as an officer of a broker-dealer for about three and one-half years before his association with registrant. Neither his belief in the future of USI and DPCA nor his willingness to speculate with his own funds justify or excuse the activities related herein.^{168/} Amann's persistent refusal to accept direction or instruction indicates that he requires close supervision. He should be excluded from association with any broker or dealer for nine months and should be allowed to resume such association after that period only if adequately supervised.

Baskin came to registrant directly following his graduation from college. The record as to him relates solely to his activities in connection with registrant's preparations for the sale of the Roseville-Detroit syndication units. Baskin shares responsibility for the misinformation registrant furnished its salesmen in respect of Roseville-Detroit. He was fully aware of the changes in Roseville-Detroit's initial registration statement, based upon the letter of comment by the Division of Corporation Finance. Under these circumstances Baskin should be suspended from association with any broker or dealer for fifteen days.

^{168/} Richard J. Buck & Co., Inc., supra; Alexander Reid & Co., Inc.
41 S.E.C. 373 (1963).

In view of the changes made by registrant in its policies and practices it may be allowed to remain in business. But the serious nature of its violations of the securities laws committed by the respondents herein and by other salesmen constrain the imposition of substantial sanctions. Registrant's membership in the NASD and PBW should be suspended for four months.^{169/} Accordingly,

IT IS ORDERED that Hodgdon & Co., Inc., now known as Haight & Co., Inc. be, and it hereby is, suspended from the National Association of Securities Dealers, Inc. and the Philadelphia-Baltimore-Washington Stock Exchange for four months; and

IT IS FURTHER ORDERED that A. Dana Hodgdon, James F. Haight, David M. Adam, Jr. and James W. Harper III be, and they hereby are, barred from being associated with any broker or dealer; and

IT IS FURTHER ORDERED that Louis S. Amann be, and he hereby is, barred from being associated with any broker or dealer with the understanding that upon an appropriate showing he may become associated with a broker or dealer in a supervised capacity after nine months; and

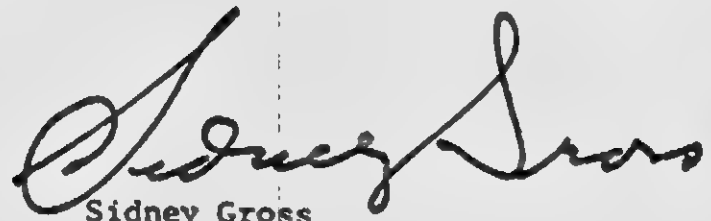
IT IS FURTHER ORDERED that Burton² Kitain and Homer E. Davis be, and they hereby are, suspended from association with any broker

^{169/} "The remedial action which is appropriate in the public interest depends upon the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken in other cases." Century Securities Company; supra.

or dealer for one year; W. Lyles Carr be, and he hereby is, suspended from association with any broker or dealer for ten months; Robert F. Kibler be, and he hereby is, suspended from association with any broker or dealer for five months and Harvey A. Baskin be, and he hereby is, suspended from association with any broker or dealer for fifteen days.^{170/}

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Commission's Rules of Practice.

Pursuant to Rule 17(b) of the Commission's Rules of Practice a party may file a petition for Commission review of this initial decision within 15 days after service thereof on him. Pursuant to Rule 17(f) this initial decision shall become the final decision of the Commission as to each party unless he files a petition for review pursuant to Rule 17(b) or the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition to review or the Commission takes action to review as to a party, this initial decision shall not become final as to that party.


Sidney Gross
Hearing Examiner

Washington, D. C.
May 15, 1969

^{170/} To the extent that the proposed findings and conclusions submitted to the Hearing Examiner are in accord with the views set forth herein they are accepted, and to the extent they are inconsistent therewith they are expressly rejected.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC.

File No. 3-533

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
JAMES L. ROPER
HARVEY E. BASKIN

MOTION OF REGISTRANT AND RESPONDENT HAIGHT
TO REOPEN THE RECORD AND RECEIVE ADDITIONAL
EVIDENCE AS TO SANCTIONS

Registrant and respondent James F. Haight respectfully seek leave to reopen the record for the limited purpose of (a) permitting the Hearing Examiner to reconsider the recommended sanctions imposed as to registrant and Haight and/or (b) adducing additional evidence relevant to the appropriateness of the recommended sanctions in light of circumstances

intervening since conclusion of the evidentiary record. To this end, registrant and Haight respectfully move for an order pursuant to Rule 11(e) of the Commission's Rules of Practice, 17 C.F.R. 201.11(e), authorizing the Hearing Examiner, notwithstanding that the initial decision has been rendered, to determine whether the instant motion should be granted. Alternatively, registrant and Haight move for an order pursuant to Rule 21(d) of the Commission's Rules of Practice, 17 C.F.R. 201.21(d), granting them leave to adduce such additional evidence.

In support of this motion, and as a part hereof, movants respectfully refer the Commission to their brief filed and served herewith, and to their proffer of additional evidence set forth therein.

DICKSTEIN, SHAPIRO & GALLIGAN

By: 

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1815 H Street, N.W.
Washington, D.C. 20006

Attorneys for Movants

May 26, 1969

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of

HODGDON & CO., INC.

A. DANA HODGDON

JAMES F. HAIGHT

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LOUIS S. AMANN

JAMES L. ROPER

HARVEY E. BASKIN

File No. 3-533

BRIEF FOR REGISTRANT AND RESPONDENT HAIGHT IN
SUPPORT OF MOTION TO REOPEN THE RECORD AND
RECEIVE ADDITIONAL EVIDENCE AS TO SANCTIONS

Preliminary Statement

Following 108 days of public hearings, the evidentiary record in this case was closed on June 15, 1967.

Twenty-three months later, Hearing Examiner Gross handed down an initial decision finding some of the Division's allegations not sustained, and others to have been

1/ proven. With respect to registrant, the Examiner concluded that "it may be allowed to remain in business"
2/ (I.D. at 148). With respect to respondent Haight, the Examiner thought his "culpability is too serious and extensive to warrant less than permanent bar" (I.D. at 142). Accordingly, the Examiner recommended that registrant be suspended from the National Association of Securities Dealers and the Philadelphia-Baltimore-Washington Stock Exchange for a four month period, and that Haight be permanently barred "from being associated with any broker or dealer" (I.D. at 148).

By this motion, registrant and Haight seek to have the record reopened for the limited purpose of showing:
(1) the sanction proposed for registrant is inconsistent with the Examiner's conclusion that it should be "allowed

1/ This motion is addressed solely to the sanction phase of the proceeding. Accordingly, we do not here challenge the Examiner's factual findings and the legal conclusions which he drew therefrom, but preserve our rights with respect to the underlying findings of violations for review before the Commission pursuant to Rule 17 of the Commission's Rules of Practice, 17 C.F.R. 201.17.

2/ The abbreviation "I.D." refers to the Hearing Examiner's initial decision served on May 16, 1969.

to remain in business" since, as a matter of economic fact, registrant cannot survive a four month suspension from both the NASD and the PBE; and (2) in view of circumstances intervening since the close of the evidentiary record in June, 1967, a substantial modification of the type and nature of the sanction recommended for registrant and Haight is warranted. In Part I of this brief, we address ourselves to these issues and specifically proffer the evidence which we would present at such a reopened hearing. In Part II, we briefly discuss the procedural issues raised by this motion.

I

A. The Economic Impact of a Four Month Suspension

Chairman Carey once pointed out that "the effectiveness of a suspension from an exchange or the NASD as a meaningful sanction varies considerably in accordance with a firm's business and its reliance for profits upon professional price concessions from members of an exchange or securities association." Hearings Before A Subcommittee of the Committee on Interstate and Foreign Commerce, On H.R. 6789,

6793 and S. 1642, p. 129 (1963). Here, the Examiner concluded that registrant should be permitted to remain in business (I.D. at 148). On this premise, he recommended that it be suspended for four months from both the NASD and the PBE, and be permitted to engage in the securities business thereafter. What the Examiner could not know was that his recommended sanction is the economic equivalent of an order of revocation, the very sanction he considered unwarranted.

If the record were reopened, registrant would show that the proposed sanction will force it out of business for all time. To this end, registrant would prove that a four month suspension from dealing in all securities^{3/} will entail a \$480,000 loss merely to cover fixed costs. Registrant will also prove that its sixty registered representatives, who now serve the firm's 20,000 customers, will be forced to either neglect their client's needs during the

^{3/} Registrant is not a member of any exchange other than the Philadelphia-Baltimore-Washington Stock Exchange and an NASD suspension would preclude its participation in over-the-counter transactions, mutual fund sales and underwritings.

suspension period or seek employment with other broker-dealers. The former possibility is scarcely compatible with the public interest, and the latter will leave the firm a denuded shell with little or no assets, no representatives, and no clients. Registrant will adduce accounting and other expert testimony on this issue and offers to prove thereby that registrant cannot survive a four month bar from all securities trading.

We will also offer expert testimony analyzing the financial impact of sanctions heretofore imposed upon large broker-dealers for the purpose of comparing such impact with the effect of the recommended sanction upon registrant. See, Shearson, Hammill & Co., Securities Exchange Act Release No. 7743, Dissenting Opinion of Member (now Chairman) Budge, p. 40 (Nov. 12, 1965).

The above-described evidence, which should be in the record for reasons which are set forth at length, infra pp. 6-16 , will enable the Examiner to fashion a recommended sanction compatible with his findings and conclusions.

B. Evidence of Intervening Circumstances

The purpose of sanctions is remedial, not punitive. As the Commission has pointed out, "the purpose of [sanctions] is not * * * to impose a penalty on an individual, but rather to protect investors against further injury at the hands of persons who have been found guilty of misconduct under the securities laws." W. T. Anderson Co., 39 S.E.C. 630, 633 (1960); Kimball Securities, Inc., 39 S.E.C. 921, 924-925 (1960). Accordingly, Commission sanctions in a case such as this are prospective, designed to protect the investing public in the future. And, as the Commission has observed, "a determination that future activities by salesmen would be consistent with the public interest should be made on the basis of the proposed activity and the conduct of the salesman in question prior to and subsequent to the misconduct here found." Ross Securities, 41 S.E.C. 509, 517 ftn. 10 (1962).

In this case, the evidentiary record closed in June of 1967. Meanwhile registrant under the leadership of respondent Haight has moved forward to enhance its

supervisory personnel and methodology; to innovate new forms of disclosure to investors; to modernize and computerize its back-office operations; and to open a sociologically desirable office in the heart of Washington's inner city. Of the myriad factors which the Commission has found relevant to the public interest, perhaps changed circumstances representing a sincere desire to comply with statutory and regulatory requirements to prevent a recurrence of violations has been considered the most persuasive factor in determining the appropriate sanction. E.g., Thompson & McKinnon, 35 S.E.C. 451, 460 (1953); Thompson & McKinnon, Securities Exchange Act Release No. 8310 (May 8, 1968); Richard J. Buck & Co., Securities Exchange Act Release No. 8482 (December 31, 1968); E. F. Hutton & Co., Inc., Securities Exchange Act Release No. 8487 (January 2, 1969); Folger, Nolan, Fleming & Co., Inc., Securities Exchange Act Release No. 8489 (January 8, 1969); Blyth & Co., Inc., Securities Exchange Act Release No. 8499 (January 17, 1969); Delafield & Delafield, Securities Exchange Act Release No. 8480 (December 26, 1968). Indeed, not infrequently the Commission has directed the respondent to

present a plan implementing appropriate changes and safeguards to prevent a recurrence of violations on pain of revocation if an acceptable proposal was not presented.

E.g., Moore & Co., 32 S.E.C. 191, 197-198 (1951); Hughes v. Securities and Exchange Commission, 174 F.2d 969, 972 (D.C. Cir. 1949). Cf. Shearson, Hammill & Co., Securities Exchange Act Release No. 7743 (Nov. 12, 1965).

Here, not only have corrective measures already been voluntarily taken, but the firm is pioneering in regulatory innovations. Since sanctions which are prospective and remedial should not be based on stale records,^{4/} and since the additional evidence which we desire to adduce could not have been presented at the hearing since the facts which we seek leave to introduce occurred since the evidentiary record was closed, that record should be reopened to receive such evidence now so the Examiner and the Commission may carefully consider the public interest issue on the basis of current facts.

At a reopened hearing, we would adduce evidence to

^{4/} Cf. American Committee v. Subversive Activities Control Board, 380 U.S. 503, 505 (1965).

show that the addition of qualified personnel, the establishment of stringent policies and safeguards, the creation of new disclosure procedures, and the investment of substantial sums of money in sophisticated equipment form a solid basis for a conclusion that the public can be permitted to deal with registrant without fear of statutory or regulatory violations. In addition, since the gravity of the sanction imposed on respondent Haight was predicated upon the Examiner's conclusion that he "failed to properly supervise registrant's salesmen" (Initial Decision, p. 142), such evidence would establish the manner in which Haight has formulated supervisory policy during that time in which he has had the power to do so.^{5/} The evidence we will proffer at the reopened hearing is summarized below.

1. Registrant's New Procedures, Disclosures and Safeguards

Since Haight assumed his duties as the firm's chief

^{5/} Until July 1964, Hodgdon as president and majority shareholder obviously dominated the firm.

executive officer in July, 1964,^{6/} the firm has instituted new and ever increasing safeguards to insure maximum compliance with the securities laws and the regulations of this Commission.

--In January of 1968, registrant established the position of Compliance Officer and appointed Mr. Menache to that job. Mr. Menache holds a bachelor's degree from the University of the Americas, Mexico City, Mexico, and has done graduate study at Baylor University and the University of Texas. He graduated from the George Washington University with a J. D. degree, and is a member of the District of Columbia bar. Responsible only to Haight, Mr. Menache was given a free hand and instructed to promulgate binding instructions and institute mandatory procedures to insure full compliance.

With his assistant, Mr. Michael Udoff, Mr. Menache engages in the following procedures to supervise the firm's registered representatives:

^{6/} An event occurring after the end of the relevant period as to which violations are alleged.

- a. Daily ticket review: Messrs. Menache and Udoff review each transaction ticket for any possible indication of improper dealings with the firm's customers. Each week or so, Mr. Menache queries the representative as to any transaction requiring explanation. Any ticket deserving of immediate investigation is promptly called to the attention of Mr. Haight.

- b. Monthly commission reports: Each month the Compliance Officer and his assistant review the representative's commission reports which give a fuller picture of transactions by a single representative than can be ascertained by non-comparative examination of a single day's transactions. Any transaction trend requiring inquiry is summarized and reviewed with the representative.

- c. Account books: On a quarterly basis, each representative appears in Mr. Menache's office with his account book and his client's accounts are individually reviewed. On several occasions, this review has resulted in careful questioning of the representative. For instance, in one recent case this quarterly review revealed an abnormally high number of transactions in speculative securities. Although the representative assured Mr. Menache that the

client had been fully informed with regard to the speculative nature of the transactions, and had expressed a specific desire to speculate, special communications were sent to the clients to assure that this was the case. A copy of that document is attached as Exhibit "A".

- d. Correspondence review: Copies of all correspondence from a registered representative to a customer are submitted to Mr. Menache or his assistant prior to mailing of the originals. These copies are customarily reviewed prior to posting of the originals and periodically the envelopes containing the originals are scanned to assure that copies have been submitted. Whenever a piece of correspondence contains statements that might conceivably be improper, the representative is directed to change the text often along lines specifically suggested by Mr. Menache. Correspondence emanating from branch offices is examined by the branch office manager prior to mailing and subsequently reviewed by Mr. Menache.

Registrant has installed special telephone equipment whereby its Compliance Officer and Mr. Haight can monitor representatives' telephone conversations with clients.

Such monitoring is done on a spot, daily basis and its deterrent effect on representatives, all of whom are made aware of monitoring activities, is readily apparent.

Registrant has also adopted strict policies with respect to several matters which caused the Examiner concern. For mutual fund redemptions, the trading department is now instructed not to execute any transactions unless (a) the order is accompanied by a form, samples of which are annexed as Exhibits B and C fully disclosing the consequences to the client or (b) the order ticket is countersigned by Mr. Menache. With respect to those clients who desire to maintain a trading account and purchase speculative securities, a registrant has adopted a policy of full disclosure with respect to risk of capital and commission costs. In addition, registrant has recently adopted a trading account agreement form setting forth such disclosures, a copy of which is annexed as Exhibit D.

Registrant has ordered and will soon be utilizing a confirmation form which will offer clients information about principal trades not usually given by broker-dealers.

The firm has a fixed policy not to accept any discretionary accounts except in the most extraordinary circumstances. No representative is allowed to maintain a discretionary account unless his request has been submitted and approved by the firm's board of directors.

The application for such approval must specify the reason for the account and make a clear showing that it is absolutely infeasible to contact the client by long distance telephone with respect to transactions. Then, and only then, will the account be considered by the board of directors for approval. Due to the new and more stringent requirements, the firm only has three discretionary accounts in its total of approximately 20,000, and even with respect to these, discretionary authority is rarely utilized.

Through a middle manager system, additional supervision is given to all registered representatives. The firm's four associate managers, Messrs. Ernest G. Ambort, Jay Ginsberg, Peter Hallock and Ralph Whitt, and branch office managers meet weekly with Mr. Haight and Mr. Menache and review the accounts of their assigned representatives. This system augments -- it does not supplant or replace --

the continuing supervision by the Compliance Officer under Haight's direction.

This evidence will establish a comprehensive and stringent supervision policy, so stringent in fact that in recent months at least two representatives have left registrant's employ and taken positions with competing firms rather than subject themselves and their client's accounts to such intimate supervision.

2. Additional Personnel and Equipment

Mr. William Redfern has been employed as Operations Manager and is now in charge of all back office operations including the administrative and record keeping functions within the trading department. A graduate of the University of Maryland, Mr. Redfern had twelve years of previous employment with Ferris & Company, in New York City, his last position being Operations Manager of that firm. --Mr. Redfern would be called to testify concerning his experience, his functions at registrant, and contemplated future developments.

Mr. Robert Lazurek, who has been with registrant since 1959, is now the firm's chief trader, a vice-president and member of the board of directors. Mr. Lazurek's reputation and standing in the securities industry will be evidenced by the fact that he is now President of the Security Traders Association of America.

The firm now has on order an NCR-200 computer representing a capital commitment of \$188,000. Evidence will be offered to establish how this highly sophisticated equipment will maximize the firm's efficiency in servicing its clients' accounts. Expert evidence will also be proffered to show how this equipment will be used as an aid to supervising compliance with respect to ratios, trading frequency, suitability and other regulatory aspects.

3. Other Aspects of Public Interest

The firm proposes to offer current data with respect to the number, nature, and constancy of its customer accounts. It will also proffer evidence with regard to the operations of its "inner city" office, the nature of

the business transacted at that office, and the desirability of permitting such an office to remain in operation.

II

As we have demonstrated, supra pp. 6-16, the additional evidence which we seek to adduce is clearly material to the public interest issue and ought to be received so that sanctions against registrant and Haight may be fashioned on the basis of a fresh record. Obviously, evidence of facts occurring after June of 1967 could not have been proved at the initial hearing.^{7/} The appropriate procedural disposition, it seems to us, is an order pursuant to Rule 11(e) authorizing the Hearing Examiner to consider this motion, to determine whether to reopen the hearing, to receive such additional evidence as he may consider advisable, and with or without a hearing, amend the proposed sanctions as may appear appropriate. Alternatively,

^{7/} Arguably, registrant could have then proved the practical and economic effect of a four-month suspension, but until the Examiner handed down his initial decision, holding that it should be permitted to remain in business but nonetheless imposing such a sanction, there was no reason for registrant to believe this evidence to be material. Gearhart & Otis, Inc. v. Securities and Exchange Commission, 348 F.2d 798, 801 (1965).

the Commission should exercise its power under Rule 21(d) and direct that the record be reopened to receive fresh evidence on the public interest issue.^{8/}

CONCLUSION

We refrain from now suggesting what the Examiner might find to be an appropriately reduced sanction against registrant and Haight since that would necessarily depend on the evidence stipulated or adduced during a hearing.

However, we observe that even with no additional evidence the sanctions should be altered so as to be consistent with the findings already made, i.e., (a) the sanction imposed upon registrant should be reduced to one which makes survival an economic possibility and (b) the sanction imposed upon respondent Haight should be altered to give appropriate effect to the finding that such a severe

8/ Neither course will materially delay this proceeding. We are prepared to proceed very promptly with such a reopened hearing and will be in a position to present our witnesses within 20 days after such a hearing has been scheduled. Moreover, should the Examiner desire or permit the parties to file additional memoranda at the conclusion of the hearing, we are prepared to abide by any reasonably accelerated schedule which the Examiner or the Commission might fix.

sanction is warranted only because of his assumed failures of supervision. As a matter of logic and Commission practice, a determination that an individual is an inadequate supervisor, should result in an order authorizing reentry in a non-supervisory, supervised capacity (Cf. Proposed sanction with respect to Louis Amann, Initial Decision, pp. 147 and 148).

But any sanction must of necessity operate prospectively and be imposed on the basis of a fresh record focused on the public interest issue. Accordingly, this motion should be granted and the Hearing Examiner should be authorized pursuant to Rule 11(e) to decide whether this motion initially should be granted, denied or otherwise resolved. Alternatively, the Commission should direct the Examiner pursuant to Rule 21(d) to reopen the record and receive the evidence.

Respectfully submitted,

DICKSTEIN, SHAPIRO & GALLIGAN

By 

Sidney Dickstein

Federal Bar Building

Washington, D. C. 20006

347-4450

Attorneys for Movants

RESTATEMENT:

Part of or all of my account has been handled as a trading account with my knowledge and consent. This trading activity, has exposed my capital to risk. Of course, a commission was charged on every transaction. In the case of over-the-counter securities recommended by the firm, I may have paid a 5% mark-up, which is a commission included in the purchase price of a security; and, therefore, did not appear under commission on my confirmation slip. Haight & Co., Inc., makes a market in several securities. The firm may have earned a profit (or loss) by purchasing securities at a price lower (or higher) than at which they sold it to me in a principal transaction. Also, in some cases the sale was a principal transaction which may have resulted in a commission less than the regular New York Stock Exchange Commission rate. All mutual funds were purchased as long term investments and where these were sold, I was appraised of the fact that I paid a sales charge of 8 - 1/2% (or less), and that the reinvestment of the proceeds in another mutual fund would entail another sales charge of a similar amount. I have received a confirmation slip on all transactions and I have been contacted prior to, or previously authorized, all transactions by Mr. Harper. I acknowledge that the above is an accurate restatement of my past dealings with Mr. Harper and Haight & Co., Inc.

EXHIBIT A

Representative

Client

Last name

First name

HAIGHT & CO., Inc.

1101 17th STREET, N. W. WASHINGTON, D. C. 20036
6300 LEESBURG PIKE, 7 CORNERS, VIRGINIA

Stockbrokers

Tel. 296-1300
JEfferson 4-8800



MEMBERS PHILADELPHIA • BALTIMORE • WASHINGTON STOCK EXCHANGE

UNSOLICITED REQUEST FOR THE LIQUIDATION OF A MUTUAL FUND

Your signature below certifies that:

1. your registered representative did not recommend the transaction to you, and;
2. you understand that mutual funds should be held as long term investments, and;
3. you understand that you may incur a tax liability if you realize a profit from the sale, and;
4. you understand that you paid a sales commission of approximately 8 1/2 % at the time of purchase and that you would have to pay an additional sales charge to purchase another mutual fund, and;
5. you understand that liquidation of a contractual plan prior to completion incurs a penalty to you and may result in a loss, and;
6. you understand that better results may or may not be available in another mutual fund and that it is impossible to predict the future performance of a mutual fund or of a mutual fund manager.

**I HAVE READ THE ABOVE PROVISIONS AND DIRECT YOU TO
PROCEED WITH THE UNSOLICITED TRANSACTION.**

Unsolicited Transaction _____

Client's Signature _____

Registered Representative _____

Date _____

EXHIBIT B

Representative

Client

Last name

First name

HAIGHT & CO., Inc.

Stockbrokers

1101 17th STREET, N. W. WASHINGTON, D. C. 20036

Tel. 296-1300

6300 LEESBURG PIKE, 7 CORNERS, VIRGINIA

Jefferson 4-8800



MEMBERS PHILADELPHIA • BALTIMORE • WASHINGTON STOCK EXCHANGE

STATEMENT OF UNDERSTANDING FOR LIQUIDATION OF MUTUAL FUND
SHARES AND REINVESTMENT OF PROCEEDS IN OTHER SECURITIES

-Your Signature Below Certifies That:

1. You understand that mutual funds should be held as long term investments, and;
2. you understand that better results may or may not be available in another mutual fund or security and that it is impossible to predict the future performance of a mutual fund or of a mutual fund manager or the price movement of a security or the future dividends to be paid by a company, and;
3. you understand that you may incur a tax liability if you realize a profit from the sale, and;
4. you understand that you paid a sales commission of approximately 8 1/2 % at the time of purchase and that you would have to pay an additional sales charge to purchase another mutual fund, and;
5. you understand that liquidation of a contractual plan prior to completion incurs a penalty to you and may result in a loss, and;
6. you have received a current prospectus with regard to any mutual fund recommended to you for purchase.

I HAVE READ THE ABOVE PROVISIONS AND HAVING UNDERSTOOD THEM

I DIRECT YOU TO PROCEED WITH THE FOLLOWING TRANSACTIONS:

Client's signature(s) _____

Date _____ Registered Representative _____

EXHIBIT C

- JA 303 -

Representative

Client

Last name

First name

HAIGHT & CO., Inc.

1101 17th STREET, N. W. WASHINGTON, D. C. 20036
6300 LEESBURG PIKE, 7 CORNERS, VIRGINIA

Stockbrokers

Tel. 296-1300
JEfferson 4-8800



MEMBERS PHILADELPHIA • BALTIMORE • WASHINGTON STOCK EXCHANGE

REQUEST FOR THE MAINTENANCE OF A TRADING ACCOUNT

The undersigned hereby requests that all or a portion of his account be handled as a trading account with a view toward speculative gain and acknowledges that there are special risks and disadvantages inherent in such an account, including:

1. Securities recommended for such an account will generally be of a speculative nature and will thereby represent a greater risk of loss of capital than in investment grade securities;
2. Trading accounts generally involve substantially greater frequency of purchases and sales than would otherwise be the case;
3. A commission is paid on each purchase and on each sale and hence the commission charges on trading accounts is substantially greater than in the case of a long term investment account; and
4. Trading activity may result in incurrence of taxes in amounts larger than those incurred in an investment account. (A security held for more than six months is eligible for capital gains tax treatment on realized gains. Capital gains tax rates are substantially lower than the ordinary tax rates.)

I HAVE READ AND UNDERSTAND THE ABOVE PROVISIONS

Client's signature(s)

EXHIBIT D

ADMINISTRATIVE PROCEEDING
FILE NO. 3-533

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
June 25, 1969

Re: Haight & Co., Inc., et al.
(Administrative Proceeding
File No. 3-533)

In these proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934, Haight & Co., Inc. ("registrant") and James F. Haight, its president, moved to reopen the hearings in order to permit the hearing examiner to reconsider the sanctions imposed on them and to adduce additional evidence with respect to the appropriateness of such sanctions, and requested that the motion be referred to the hearing examiner. The Division of Trading and Markets filed a memorandum in opposition to the motion.

The hearing examiner, following hearings, had issued his initial decision which among other things suspended registrant from the Philadelphia-Baltimore-Washington Stock Exchange and the National Association of Securities Dealers, Inc. for a period of four months and barred Haight from association with any broker or dealer. Movants asserted and sought to introduce evidence to show that, since the close of the hearings, registrant had added supervisory personnel, ordered and installed new equipment and adopted new policies and procedures which would protect the public against further violations; and claimed that the bar imposed on Haight was based upon a failure of supervision and that evidence of those changes would show how he had formulated supervisory policy during the time "he has had the power to do so." Movants also sought to introduce evidence that would assertedly show that although the examiner concluded that registrant may be allowed to remain in business the sanction he imposed would effectively put registrant out of business; and to introduce "expert testimony" comparing the financial impact of the sanction imposed on registrant with that of sanctions imposed by the Commission on large broker-dealers in other cases.

The Commission noted that the order for proceedings, dated March 2, 1966, charged misconduct on the part of movants during the period May 1960 to June 1964; that Haight became registrant's chief executive officer in July 1964; and that the hearings in these proceedings were not concluded until June 1967. It observed that, apart from the fact that the examiner's imposition of a bar against Haight was based upon findings of serious substantive violations by him of the securities laws as well as a failure of supervision, movants had had an ample opportunity at the hearings to adduce evidence showing how Haight had "formulated supervisory policy" at registrant in view of the fact that he had served as its chief executive officer for three years by the time the hearings were concluded. In fact, movants' proposed findings of fact submitted to the hearing examiner (at pp. 449-453) detail evidence in the record showing assertedly "significant" changes made in the nature of registrant's business and procedures, including changes in the type of securities activities conducted, and "more stringent controls" imposed on the firm's representatives in the form of increased supervision and review of transactions, after Haight became registrant's president and major shareholder. The examiner expressly stated in his initial decision (at pp. 140-1, 148) that it was in part because of such changes that he concluded that the public interest did not require the revocation of Haight & Co.'s broker-dealer registration. The Commission also observed that registrant had had full opportunity at the hearings to adduce evidence as to the impact of any sanction that might be imposed on it. 1/

The Commission, noting that it had in prior cases denied requests to reopen hearings for the purpose of adducing evidence as to the subsequent conduct of respondents, 2/

1/ Cf. M. S. Wien & Co., 24 S.E.C. 227, 229-30 (1946).

2/ Norris & Hirshberg, Inc., 22 S.E.C. 558, 559 (1946); Isthmus Steamship & Salvage Co., Inc., Securities Exchange Act Release No. 7476, p. 5 (December 2, 1964); Crow, Brouman & Chatkin, Inc., Securities Exchange Act Release No. 7876, p. 2 (April 29, 1966); Melvyn Hiller, Securities Exchange Act Release No. 8476, p. 4 n. 8 (December 24, 1968).

concluded that it should not grant reopening in the instant case. It considered that such reopening here, after the filing of the hearing examiner's initial decision following the development of a voluminous record and the submission of extensive proposed findings and briefs to him on all the issues, would under the circumstances be an inappropriate departure from orderly procedures and an unwarranted prolongation of the proceedings, particularly since the additional evidence sought to be introduced either appeared to be essentially cumulative or could have been introduced at the hearings. Moreover, it was noted that movants would have the opportunity to argue any questions pertinent to the appropriateness of the sanctions on review of the hearing examiner's initial decision by the Commission.

Accordingly, the Commission denied the motion as well as the request to refer decision of such motion to the hearing examiner.

By the Commission.

Orval L. DuBois
Secretary

3-533-1
R/A
ADMINISTRATIVE PROCEEDING
FILE NO. 3-533

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
July 23, 1969

SECURITIES & EXCHANGE COMMISSION
MAILED FOR SERVICE

JUL 24 1969

804319

CTFD. NO.

804323

In the Matters of

HAIGHT & CO., INC.
(formerly HODGDON & CO., INC.)
1101-17th Street, N. W.
Washington, D. C.

(8-8427)

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER, III
LOUIS S. AMANN
HARVEY A. BASKIN
HOMER E. DAVIS
ROBERT F. KIBLER

ORDER FOR
REVIEW OF
INITIAL
DECISION

Securities Exchange Act of 1934 -
Sections 15(b), 15A and 19(a) (3)

In these broker-dealer proceedings pursuant to Sections 15(b), 15A and 19(a) (3) of the Securities Exchange Act of 1934, the hearing examiner filed an initial decision in which he concluded, among other things, that it is in the public interest to suspend Haight & Co., Inc. from the Philadelphia-Baltimore-Washington Stock Exchange and the National Association of Securities Dealers, Inc. for a period of 4 months; to bar A. Dana Hodgdon, James F. Haight, David M. Adam, Jr., James W. Harper, III and Louis S. Amann from association with any broker or dealer, with the proviso that, after nine months, Amann may become so associated in a supervised capacity upon an appropriate showing; and to suspend Burton Kitain, W. Lyles Carr, Jr., Harvey A. Baskin, Homer E. Davis and Robert F. Kibler from any such association for respective periods of one year, 10 months, 15 days, one year and 5 months.

Respondents have filed petitions for review excepting to various findings and conclusions of the examiner and raising certain other issues. The Division of Trading and Markets of the Commission has filed a petition for review urging that the sanctions imposed by the examiner on Kitain and Carr are inadequate. The Commission determined to grant the petitions for review, and, pursuant to Rule 17(c) of its Rules of Practice, to review the hearing examiner's initial decision on its own initiative with respect to the issues which were before him concerning all the respondents.

Accordingly, IT IS ORDERED that the petitions for review of respondents and the Division of Trading and Markets be, and they hereby are, granted, and that the hearing examiner's initial decision be, and it hereby is, made the subject of review with respect to all other issues which were before him concerning all of the above-captioned respondents. Respondents and the Division of Trading and Markets may file briefs within 30 days after service of this order, and may file reply briefs within 30 days thereafter.

By the Commission.


Orval L. Dubois
Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
February 19, 1971

In the Matters of

HAIGHT & CO., INC.
(formerly HODGDON & CO., INC.)
1101-17th Street, N.W.
Washington, D. C.

(8-8427)

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
HARVEY A. BASKIN

FINDINGS AND
OPINION OF
THE COMMISSION

Securities Exchange Act of 1934 -
Sections 15(b), 15A and 19(a)(3)

BROKER-DEALER PROCEEDINGS

Grounds for Remedial Action

Fraud in Offer and Sale of Securities

Sale of Unregistered Securities

Falsification of Records

Failure to Amend Application for Broker-Dealer
Registration

Failure to Transmit Proceeds of Offering
Promptly

Where registered broker-dealer and associated persons represented themselves to be financial planning experts who would choose the best securities for their clients but, contrary to such representation, substantially limited their recommendations to securities yielding respondents greatest profits, made false and misleading representations in sale of various securities, sold unregistered securities, and falsified certain of registrant's records; and where registrant failed to amend application for broker-dealer registration to disclose election of certain officers and directors, and, while acting as underwriter, failed to transmit promptly to issuer proceeds of sale of issuer's stock, held, willful violations of securities acts, and in public interest to revoke registration of broker-dealer, expel it from

membership in national securities exchange and registered securities association, and bar associated persons who participated in such violations from association with any broker-dealer.

Practice and Procedure

Respondents' contentions that, among other things, discussion of certain of their activities in Commission's Special Study report evidenced prejudgment, that Commission improperly refused to make proceedings private, that Commission staff suppressed evidence favorable to their defense, that they were prejudiced because of sweeping nature of allegations against them, that institution of proceedings was unduly delayed, and that hearing examiner's initial decision did not comply with Administrative Procedure Act, rejected.

APPEARANCES:

Alexander J. Brown, Jr., William R. Schief, Paul F. Leonard, Harold Webb, Wallace L. Timmeny, and Charles McCarthy, Jr., for the Division of Trading and Markets of the Commission.

Sidney Dickstein and David I. Shapiro, of Dickstein, Shapiro & Galligan, and Harry Heller, of Simpson Thacher & Bartlett, for Haight & Co., Inc., James F. Haight, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper III, Burton Kitain, Homer E. Davis and Robert F. Kibler.

Harold P. Green, Richard Schifter, and David E. Birenbaum, of Strasser, Spiegelberg, Fried, Frank & Kampelman, for A. Dana Hodgdon.

Louis E. Shomette, Jr., of Shafer, Shomette & Stanhagen, for Louis S. Amann.

Robert B. Hirsch and Allen G. Siegel, of Arent, Fox, Kintner, Plotkin & Kahn, for Harvey A. Baskin.

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Following extensive hearings in these proceedings pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 ("Exchange Act"), the hearing examiner filed an initial decision in which he concluded, among other things, that Haight & Co., Inc. ("registrant"), a registered broker-dealer which operated under the name Hodgdon & Co., Inc. during the relevant period, should be suspended from membership on the Philadelphia-Baltimore-Washington Stock Exchange ("PBW") and in the National Association of Securities Dealers, Inc. ("NASD") for four months, and that A. Dana Hodgdon, who was president of registrant, James F. Haight, his successor as president, and David M. Adam, Jr. and James W. Harper III, vice-presidents, should be barred from association with any broker or dealer. He further concluded that certain lesser sanctions should be imposed upon Louis S. Amann, who was a vice-president of registrant, W. Lyles Carr, Jr., treasurer, Burton Kitain, secretary, Harvey A. Baskin, who was Hodgdon's assistant, and Homer E. Davis and Robert F. Kibler, salesmen. We granted petitions for review filed by respondents and our Division of Trading and Markets ("Division") as to certain issues, and, pursuant to Rule 17(c) of our Rules of Practice, ordered review of the examiner's decision with respect to all other

issues which were before him concerning respondents. ^{1/} Respondents and the Division filed briefs and we heard oral argument. Our findings are based upon an independent review of the record.

Fraud in Securities Transactions

1. Scheme to Defraud "Financial Planning" Clients

Between May 1960 and June 1964, registrant, together with or willfully aided and abetted by Hodgdon, Haight, Carr, Adam, Harper, Kitain, Davis and Kibler, engaged in a scheme to defraud customers who utilized registrant's financial planning services in the purchase and sale of securities, in willful violation of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. The record shows that the gist of the scheme was respondents' holding themselves out as financial planners who would exercise their talents to make the best choices for their clients from all available securities, when in fact their efforts were directed at liquidating clients' portfolios and utilizing the proceeds and their clients' other assets to purchase securities which would yield respondents the greatest profits, in some instances in complete disregard of their clients' stated investment objectives. This scheme was implemented by, among other things, registrant's advertising and by its training course for salesmen.

a. Advertising and Sales Training and Instructions

During the period in question, frequent advertisements extolling the virtues of registrant's financial planning services and obviously designed to attract unsophisticated investors were broadcast over a local radio station. Representative advertisements, prepared by public relations counsel with Hodgdon's assistance, were:

"We would like to issue a special invitation to new investors ... [W]hen you talk with a Hodgdon & Company representative about investments, your eyes will really be opened to a fascinating field of financial opportunities -- for long range gain, immediate gain -- whatever best suits your individual needs."

"[Y]ou'll be welcomed by a counsellor who is an expert in financial planning in the field of securities ... a man to ... trust implicitly."

"Hodgdon and Company has ... a research staff that has thoroughly and competently analyzed the probable course of the market."

"With proper strategy ... you [can be guided] to a life of financial security."

"Trained investment analysts are on hand to go over your present portfolio and make worthwhile suggestions."

^{1/} Thus, contrary to respondents' contention, the Division was free to object to findings and conclusions in the initial decision although not excepted to in its petition for review.

"Registered representatives at Hodgdon are always alert for new opportunities for investment, while never forgetting long-established stocks, bonds, mutual funds and the like. In short, a balance is maintained between the new and the tried-and-true."

"Call in an investment expert, one of the many informed specialists at Hodgdon and Company."

"It is entirely probable that [the next twelve months] could bring prosperity ... if you take the counsel that is available to you - free of charge." 2/

In fact, registrant had no research staff, and its "expert counsellors in financial planning" included inexperienced salesmen who, after about a year's employment at registrant, were allowed to formulate financial plans for clients without supervision. Haight admitted that registrant's so-called "specialists" in various fields had "something less than expert or professional knowledge," 3/ and, as discussed below, registrant largely ignored "long-established" stocks and bonds.

Registrant conducted its training course for new salesmen largely through Haight who, as a vice-president and later executive vice-president, was in charge of training and sales. Salesmen were instructed to tell prospects about registrant's "unique" financial planning service under which securities would be purchased in proportions designed to meet the clients' objectives, with about 50% of their funds being placed in mutual fund shares, 30% in a middle category lumping "blue chips" and real estate securities, and 20% in speculations and/or "special situations." 4/

Despite registrant's emphasis on the availability of all types of securities and the representation that high-grade securities or "blue-chips" would be included in the middle category of clients' investments, recommendations of listed securities were infrequent. Instead, registrant stressed securities on which it and the salesmen could make

-
- 2/ Registrant's radio advertising also suggested that listeners request a copy of its brochure, "Action Makes the Difference," which was written by Hodgdon and used by the firm's sales staff in soliciting new clients. The brochure stated, among other things, that "the 'haves' hold wealth in the form of stocks, real estate and oil, the 'have-nots' ... in the form of insurance savings, Government Bonds, and deposits in lending institutions," and that financial counseling could help the "have-nots" become "haves" and "provide [the best] financial blueprint for the future."
 - 3/ Several salesmen testified that they did not find the "specialists" who were supposed to assist them in their dealings with clients to be particularly knowledgeable or helpful, and stopped using them.
 - 4/ "Special situations" referred to companies assertedly having a special potential for growth such as a patent or a new process. Carr and Kitain both testified that a "special situation" involved high risk.

more money, i.e., mutual fund shares and underwritten offerings on which high commissions are charged, and unlisted securities, particularly those in registrant's inventory, that could be sold at a markup. 5/ Registrant's policy was reflected in a January 1961 memorandum from Haight and Carr, who was then senior vice-president, secretary and a substantial stockholder, to the other officers of the firm. It recommended that the salesmen be told occasionally what "blue chip" securities investment companies were buying and selling or registrant was recommending so that in "initial" conversations with prospects the salesmen could "discuss" them and thereby show that the firm did not deal in only "high commission situations," but stated that a great deal of listed securities would probably not be sold because of low commissions and greater emphasis on other situations. The lumping of real estate securities, a high percentage of which were underwritten by registrant, with blue chips was, as the examiner found, improper and designed to encourage the inference that such securities were of the same high quality as blue chips.

Various requirements and inducements were created by registrant to make salesmen produce a volume of transactions that would earn a high return. Salesmen were instructed to try to obtain clients who would follow the investment programs suggested by registrant, and were told to make at least 40 telephone calls daily to develop new clients, using lists of names obtained from telephone directories or elsewhere, and to conduct at least two interviews a day. Each salesman who had been with the firm for a year or longer was required either to sell \$18,000 in mutual fund shares or the equivalent each month, or five mutual fund contractual plans in each two-month period, or to earn commissions netting him \$600 per month from sales of securities designated as "high quality" by registrant, which included most of registrant's underwritings and securities in its inventory. 6/ Failure to meet these quotas was ground for and did occasion dismissal. Salesmen were issued lists of "preferred" mutual funds, all of which gave registrant reciprocal business, and registrant paid bonuses semi-annually for sales of \$30,000 or more of the shares of those funds. The fund which was most stressed, and most recommended and sold, was Aberdeen Fund of whose distributor Hodgdon was a director and stockholder until sometime in 1963. 7/ When registrant engaged in an underwriting, salesmen were asked to indicate the amount of the issue they thought they could sell,

5/ Hodgdon testified that registrant's salesmen had only minor activity in listed securities because they were "not attuned to trading back and forth in this type of thing." Carr instructed salesmen to tell prospective clients that registrant handled stocks on "all the Exchanges," but stated to the salesmen that he very seldom recommended blue chip or listed stocks since investors "became discouraged and didn't understand" if the stocks failed to appreciate in value. He told the salesmen that "professionals" (apparently referring to mutual funds) could pick a blue chip stock better than they, and that in recommending securities they should consider the commission to be earned.

6/ The salesmen's compensation from registrant was based solely on their sales.

7/ The Aberdeen Fund shares were sold either on a contractual plan with a front-end load, or on a lump sum basis.

and pressure was applied if they failed to dispose of the indicated quantity. 8/ At weekly staff meetings, salesmen were given a list of securities in inventory, the number of shares registrant wished the salesmen to sell, and the commissions for selling them. If the firm's position in a security became larger than desirable, the sales commission was increased.

Registrant's sales staff was taught by Haight, Carr, Hodgdon and others to utilize a variety of high pressure and fraudulent tactics to obtain financial planning clients and then induce them to convert their assets, including their portfolios, into securities yielding respondents high profits. For example, Haight told salesmen to appeal to the prospect's fears 9/ and greed, to give clients only such facts as were necessary to support a sales presentation, and to dominate the interview, dramatize the facts, appeal to the client's sense of prestige, 10/ create a sense of urgency, and attempt to make each sale worth more. Another instructor taught the salesmen always to assume a sale when attempting to make one, and to use the "physical action close" in selling mutual funds, which meant to start filling out the application form in front of the client before he had expressed a willingness to buy.

Carr suggested to the salesmen various reasons that could be given to clients to induce them to sell their portfolio securities so as to free funds for investment in securities recommended by registrant. He told salesmen to recommend securities in an area where registrant had something to sell, or try to sell the client whatever was "easiest." He taught that, in selling, emotion was more important than logic, and that, "An ounce of enthusiasm at the proper time is worth a pound of knowledge." 11/ He suggested that if a customer wanted to read a prospectus the salesman should make him buy first by stating that the order could be cancelled later, since once a person owned a stock he read the prospectus differently. However, if the customer later did decide to cancel, Carr told the salesman to say, "What cancel! You should have doubled your order."

Another asset of customers stressed in salesmen's training as a source of money for securities purchases was the life insurance policy. The salesmen were instructed by registrant's insurance "specialist," with whom they were required to consult before recommending to clients any changes in their insurance holdings, to "Get [the client's] cash first, then go after insurance, our only purpose in discussing insurance is to free more monies." This instruction stands in stark contrast to the statement in registrant's financial planning brochure that the firm's "insurance counselling service" was "the most important

8/ Hodgdon had a proprietary interest in several of registrant's underwritings. He told one salesman, who did not want to sell one of such underwritings because he considered it "an extremely high risk," that his cooperation on the underwriting was "vital to the interests of the firm" and that he was expected to do his part.

9/ Among other things, salesmen were told to stress the impact of inflation on savings and to dramatize the need for higher returns by citing "statistics" such as "54 men out of every 100 are living on friends, relatives and charity" and "50% of all Connecticut doctors who died in the last 10 years died bankrupt."

10/ One of registrant's instructors suggested that, in the sale of a gas and oil security, clients be told that they were being offered the opportunity of associating with the extremely wealthy in offsetting income and reducing tax obligations.

11/ Carr told the salesmen they should "hit [the] 'hot button'", which he defined as stressing the objective "dearest to [a client's] heart."

opportunity we can offer the average person who has only seen his protection program from the point of view of the life insurance salesman who sold it to him." In connection with one of registrant's underwritings, Carr told the sales staff to "find the easiest money first, such as savings and loan money [and the] cash value of life insurance policies.

b. Transactions with Clients

We now discuss the manner in which registrant's salesmen, as well as officers, applied the fraudulent techniques described above in their dealings with financial planning clients.

Adam

Adam, who joined registrant as a salesman in 1960, became a "group manager" in 1962, supervising about five salesmen, and in 1963 was appointed an assistant vice-president.

Dr. G, an anaesthesiologist, became a financial planning client of Adam in August 1960. At that time she owned listed securities worth about \$30,000 and had a life insurance annuity purchased for \$40,000 and \$7,000 in cash. In December 1960, at Adam's request, Dr. G gave him discretionary authority over her account, because, according to Adam, she had a "complete lack of knowledge of investments and Financial Planning." At his suggestion, she deposited all dividend checks in her account with registrant for reinvestment as Adam saw fit.

In January 1963 and March 1964, Adam sent to Dr. G analyses of her account under his stewardship. The 1963 report showed a net loss of about \$200 on purchases effected up to that time which was attributed to a severe market decline in 1962, but congratulated Dr. G on the overall performance to date. It concluded, "as we continue to work together over the years, we are planning to double the amount of invested capital." The 1964 report showed there had been a profit of about \$7,000; ^{12/} and, in an accompanying letter, Adam wrote, "During the next 5 - 10 years your net worth could easily amount to \$120,000 minimum rather than the present \$75,000. Let's keep it up." However, neither report took into account or mentioned Dr. G's total loss in 1962 of her \$11,000 investment in a speculative security purchased at Adam's suggestion.

During the relevant period, Adam caused Dr. G to sell her entire portfolio of listed securities and cash in her annuity, and to purchase securities with the proceeds. Her total purchases consisted of about \$30,000 in Aberdeen and another mutual fund, \$12,500 in highly speculative gas and oil programs, and about \$50,000 in other securities, ^{13/} almost all of which were new issues that registrant was underwriting or for which it was acting as a member of the selling group, and stocks which registrant sold as principal at a markup.

^{12/} In a note, the report stated that the client's purchases of gas and oil programs for \$7,000 in 1963 and 1964 were not reflected, but no indication was given of the value of those securities.

^{13/} These figures represent total purchases, including purchases paid for with proceeds of the sale of other securities purchased during the period. This is also the case with respect to the purchases in a number of other customer accounts described below.

Capt. S had a portfolio of individual securities valued at \$45,567, in addition to shares in two mutual funds, when he became a financial planning client of Adam in 1960. Acting entirely on Adam's advice, Capt. S sold all but about \$1,600 worth of his original portfolio aside from the mutual fund shares to buy other securities recommended by Adam, cashed in two life insurance policies to buy into one of registrant's real estate syndications, and obtained three bank loans totaling \$12,400 to finance other securities purchases. Of a total of around \$71,000 in securities purchased on Adam's recommendations, \$61,000 represented securities sold by registrant as underwriter or principal. 14/ In September 1962, Adam sent Capt. S a progress report which showed losses in every category of investment except in the two mutual funds in his original portfolio. Adam nevertheless wrote, "You must be complimented on your successful accumulation of wealth over the years. This success places you within the top 4% of all individuals in the country!"

Harper

Harper joined registrant as a salesman about the end of 1960. In about 1962, he was designated a "specialist" in the gas and oil programs offered by registrant to investors and he lectured to trainees in that area. He was appointed an assistant vice-president of registrant in 1963.

In about April 1961, Mrs. D, a divorcee with a dependent son, became a financial planning client of Harper. At that time she had a portfolio of high grade securities worth about \$200,000 which she had acquired through inheritance and gifts. Her yearly income consisted of about \$7,500 from her securities, and \$2,400 in alimony which she told Harper she was fearful of losing and which she needed "to sustain herself." She also told Harper that she would like to increase the income from her portfolio but that any changes were to be into safe and well-seasoned stocks. As Harper was aware, Mrs. D was a wholly unsophisticated investor. He told her that registrant specialized in "estate planning," and that she need not be concerned about stocks and bonds since she would have "expert advice." In August 1961, at a time when Mrs. D had already followed Harper's recommendations in selling about \$25,000 worth of her portfolio and purchasing about the same amount of securities with the proceeds, Harper suggested a plan which involved the sale of a large additional portion of her portfolio. He told her that the securities to be sold had low yields and were overpriced and that she should move into "less risky" investments. Mrs. D agreed to the plan with Harper's assurance that his suggested changes made her position more secure. 15/ Mrs. D was forced to use proceeds

14/ In November 1961, Capt. S purchased additional shares of a speculative security, which he had previously purchased at Adam's suggestion at a higher price, on Adam's recommendation that he should average down his cost per share, Adam representing that he had received word that the stock "was still a good buy." On the same day, however, Adam had advised Dr. G to sell the same security, in part because of adverse information he had received concerning the company.

15/ Harper wrote to Mrs. D that if she were willing to take risks, he could assure her of \$1 million but "we are now keeping you comfortable and moving you towards the \$500,000 - \$750,000 level ... You are 50% better off today than you were [six days earlier] ... G.M. and Merck could now collapse and you would not be hurt."

from the sale of securities to pay the capital gains tax with respect to the portfolio securities she sold in 1961. The written financial plan which Harper submitted to her in October of that year placed in the "high grade" investment category registrant's unseasoned real estate syndications which Harper had sold her.

At the end of September 1962, Mrs. D wrote to Harper that her primary reason for making such drastic changes in her portfolio had been additional income, and yet her 1962 income to date, \$5,194, had been only \$168 more than for the comparable period in 1961. Harper replied that she was much "better off" than \$168 and that he still stood by "our projection of \$15,000 to \$18,000 income by 1964."

During the relevant period, Mrs. D, upon Harper's recommendations, sold more than \$122,000 worth of securities from her original portfolio. On his advice she effected purchases of \$20,000 in Aberdeen, \$2,200 in another mutual fund, about \$14,600 in a highly speculative gas and oil program, and about \$87,000 in other securities, more than \$82,000 of which registrant sold as underwriter, selling group member or principal. Of the latter amount, about \$69,000 was placed in new issues which registrant was underwriting or for which it was acting as selling group member, notwithstanding her pleas for well-seasoned and safe investments.

Harper told Mrs. M, an inexperienced investor whose goal was retirement income, that she should consider him like a doctor who would be able to diagnose her financial potential. She testified that she relied on Harper and usually followed his recommendations. Although Mrs. M stressed her desire for liquidity, Harper recommended and sold to her limited partnership interests in various real estate syndications which registrant was underwriting, assuring her that, in the event of an emergency, she could get her money out in a relatively short time. However, registrant only maintained "work-out" markets for such securities in which an investor could not dispose of them unless there were a buyer available. When some of the syndications ran into difficulties, registrant was unable to find buyers for all those who wished to sell. After the distributions were reduced on two of the syndications purchased by Mrs. M, she expressed a desire to dispose of them but Harper dissuaded her from attempting to do so. He called her several times before persuading her to buy another security which was highly speculative and about which Mrs. M felt "very insecure," representing to her that she could probably double her money in two or three years. Mrs. M's total purchases through Harper amounted to about \$27,700. Mutual fund shares accounted for about \$2,500 of this amount, and new issues which registrant was underwriting and securities sold by registrant as principal accounted for nearly all of the remainder.

In progress reports to another client, Dr. B, Harper placed Dr. B's investments in registrant's real estate syndications in the "high grade" category along with the client's mutual fund holdings, and in one such report placed a gas and oil program which he had sold Dr. B into that category. On Harper's recommendations, Dr. B sold securities initially held by him for about \$19,000, and thereafter effected purchases of about \$26,000 in gas and oil programs, \$11,000 in mutual funds and \$73,000 in other securities, of which latter amount about \$50,000 represented securities underwritten by registrant or sold as principal.

Kitain

Kitain joined registrant in 1959. In the following year he was appointed manager of a new suburban branch office, and in 1963 became an assistant vice-president.

Mrs. Y became a financial planning client of Kitain early in 1961. At that time she had a diversified portfolio of high grade stocks and bonds valued at between \$90,000 and \$100,000, the management of which until then had been entrusted to relatives who paid her a quarterly allowance from the dividends and reinvested the remainder. She felt that her portfolio was not being given enough attention, and wanted "closer consultation" with a knowledgeable adviser since she herself was "ill informed" as to investments. Kitain told her that many of her stocks were of doubtful quality, that her portfolio was too conservatively invested for someone who was not dependent on the income, and that she should sell the bulk of it and divide \$50,000 of the proceeds equally between Aberdeen and another mutual fund which were more growth oriented. In partial fulfillment of Kitain's plan, Mrs. Y sold more than \$30,000 of her portfolio and invested \$30,000 in the two mutual funds. She was not told that the mutual fund purchases entailed commission costs substantially higher than those charged on the purchase of listed securities, nor was she advised of the large tax liability on the profits she would realize from the sale of her portfolio stocks.

Mr. R was a foreign service officer, married and with three small children. He had an annual salary of \$10,000, a mortgaged home, \$4,500 in cash and Government bonds, and small holdings of three listed securities. He told Kitain that his objectives were to provide for the college education of his children and to supplement his retirement income. Although Mr. R had been successful with one speculation and was interested in similar opportunities, he told Kitain that "generally speaking" he wished to continue buying safe growth stocks like those he already held. However, Kitain discouraged Mr. R from purchasing listed securities, recommending instead that he buy Aberdeen and another mutual fund. He also told Mr. R that he could afford to speculate, and that it would be possible to convert his life insurance policies to lower-cost insurance which would give the necessary protection and still free capital to invest in speculative situations. Mr. R converted certain insurance policies and borrowed on others, investing at least part of the proceeds in securities, including two of a speculative nature recommended by Kitain. He also on Kitain's advice made bank borrowings to effect securities purchases.

Mrs. A, another financial planning client of Kitain with a very limited knowledge of securities, had prior to purchasing \$15,000 worth of Aberdeen Fund shares pursuant to his recommendation complained that withdrawal of that amount from her savings and loan account would mean a yearly loss of about \$600 in interest. Kitain advised that she could make quarterly withdrawals of \$125 from her Aberdeen shares which would be covered by the fund's dividends. In fact, those dividends only partially covered the withdrawals and when Mrs. A discovered, after three withdrawals, that she was consuming principal, she stopped the withdrawals. As of the date of her last withdrawal, the price per share was slightly lower than it had been at the time of her purchase. Kitain recommended and sold one speculative stock to Mrs. A on the representation that it was a better investment than the stock of another company in the same industry that had had a rapid rise in value. When the market price of the stock dropped she asked Kitain what was wrong and he replied, according to his testimony, that his firm was "not concerned" and a number of clients who had not had an opportunity to purchase the security could now purchase it at the lower price. Of the \$34,500 worth of securities in addition to

Aberdeen that Mrs. A purchased through Kitain, all but about \$6,000 represented new issues sold by registrant as underwriter or selling group member and securities which it sold as principal.

Davis

Davis joined registrant as a salesman in 1957. Mr. and Mrs. M, who were inexperienced investors with investment objectives of long-term growth with a view to future financial independence, became financial planning clients of Davis early in 1960. Davis explained the concept of financial planning to them and told them that they "would have to have complete confidence in him [and] confide in him totally," and that with his expert help and that of registrant's staff of experts, the proper type of investments would be made for them. He recommended mutual funds and also told the M's they could afford to buy speculative issues, stating that he did not know of anyone who ever got rich on blue chips because such stocks just varied a few points, and that the speculative securities he recommended would be "the blue chips of tomorrow."

In recommending investments to the M's, Davis represented that they would make great profits, generally within a specified time. He stated, for example, that one speculative security would double in value in about two years and that another security being issued at \$4 would rise 1 to 3 points. As a rule, the M's did not receive a prospectus on new issues which they purchased until they got their confirmations, and relied on Davis' representations. On one occasion, however, Mr. M insisted on seeing a prospectus before purchasing a speculative issue Davis was recommending. Davis reluctantly agreed, stating "I will send it, but don't pay attention to it. It will not reflect what the situation truly is." When Mr. M read the prospectus and told Davis that the stock looked "dreadful," Davis replied that he should ignore the prospectus, that prospectuses always painted a very bleak picture and that if people based their investment decisions on them "no one would ever put a cent into anything."

Davis and registrant's insurance "specialist" also advised the M's to cash in their life insurance and purchase lower-cost term insurance, telling them that they would be notified when, with proper investments, they had become self-insured, at which point they could cancel their term insurance as well. The M's followed the advice, purchasing term insurance through registrant's specialist, and investing the proceeds obtained by surrendering their original policies in securities which Davis recommended. Again acting on Davis' advice, they borrowed \$5,200 for investment in two of registrant's real estate syndications and abandoned their original intention of purchasing a farm, Davis telling them that they were better off investing in things that "would be making [them] money." Apart from two purchases of listed securities initiated by the M's, virtually all of their total securities purchases of \$22,574 effected upon Davis' recommendation represented mutual funds, new issues underwritten by registrant, and securities which registrant sold as principal.

Davis had discretionary authority with respect to the financial planning account of Cdr. C, a naval aviator stationed overseas. Consistent with respondents' scheme, of total purchases of \$14,981 in that account, \$13,256 represented new issues of which registrant was the underwriter and securities which it sold as principal.

Kibler

Kibler joined registrant as a salesman in 1960. Mrs. S, an elderly widow with a portfolio consisting largely of listed securities having a value of about \$50,000, became his client in 1962. Her stated objectives were greater income and safety, which, according to Kibler and as he advised her, were to be achieved by raising portfolio quality through elimination of weaker issues, increasing the efficiency of management by reducing the number of securities held, and placing the proceeds of sales in "high quality, diversified, and professionally managed investments." Acting on Kibler's advice, Mrs. S sold more than half of her portfolio and invested about \$12,500 in mutual fund shares and \$19,500 in other securities, of which all but one small purchase were new issues which registrant was underwriting and securities which it sold as principal.

Dr. J, a federally-employed veterinarian, had a portfolio consisting of \$7,000 invested in Government bonds and about \$18,000 in high-grade securities. The financial plan which Kibler prepared for him specified a minimum financial goal of \$87,000 to be accumulated by age 65, and safety as one objective. It recommended, among other things, that the Government bonds be sold, and that Dr. J's life insurance policies be converted to decreasing term insurance "to increase death protection coverage during period of growth of investment program." Among other things, Kibler told Dr. J that registrant's real estate syndications which he recommended would be "easily marketable," and that this Commission required that prospectuses "not be particularly glowing" and "play down the future or well being" of the company whose securities were being offered. Dr. J sold his Government bonds and other securities and reinvested the proceeds pursuant to Kibler's recommendations. During the relevant period, apart from the replacement of a few of the listed securities in his portfolio with other listed securities, Dr. J invested about \$25,500 in mutual fund shares, new issues which registrant was underwriting, and stocks which registrant sold as principal.

Hodgdon

Mrs. W, who lacked investment experience, owned securities in a custodial account managed by a bank. She told Hodgdon that she was dissatisfied with the income from that account and, at his suggestion, transferred a substantial amount of municipal bonds from the bank to her account with registrant so that Hodgdon could sell them and reinvest the proceeds. During the relevant period, Mrs. W, acting on Hodgdon's recommendation, sold about \$33,000 worth of municipal bonds and purchased \$35,000 worth of other securities, of which \$30,000 was invested in two speculative new stock issues that registrant was underwriting, and the remainder in stocks which registrant sold as principal. The yield on the securities purchased at Hodgdon's recommendation was "a good deal less" than she had been receiving before transferring the bonds from her custodial account.

Haight

Miss T, an elderly woman with a high-grade diversified securities portfolio worth about \$62,000, became a financial planning client of Haight in 1960. She told him she wanted increased income for her impending retirement. The financial plan which Haight prepared recommended, among other things, that 50% of Miss T's investment capital be placed in Aberdeen and another fund, 35% in individual securities

and real estate "all having outstanding quality characteristics," ^{16/} and 15% in "special situations and/or intelligent speculations." He told Miss T that "investment companies were safer than having everything in stocks." Miss T sold about \$28,000 worth of securities from her original portfolio. She purchased shares of Aberdeen and another mutual fund totaling \$17,000, and other securities totaling \$55,500, of which all but about \$700 represented new issues being underwritten by registrant and securities sold by registrant as principal.

Miss B, also an elderly woman, with a portfolio of high-grade securities worth \$120,500, sold mainly on Haight's advice over \$52,000 worth of that portfolio. On his recommendation, she purchased shares of Aberdeen and another mutual fund totaling \$20,000, and other securities totaling about \$54,000, over \$48,000 of which represented new issues which registrant was underwriting and securities which registrant sold as principal.

Carr

In 1961, Col. F, who was stationed overseas and had limited means, gave Carr discretionary authority over his financial planning account. All of the 10 stocks in his portfolio were sold for about \$7,800 and replaced with securities selected by Carr which, except for one minor purchase, consisted of Aberdeen shares and five new issues registrant was underwriting. Although all the securities purchased declined in value, Carr in 1962 advised their retention and suggested additional securities purchases before the market rose again. In 1963, after a further decline, Carr stated that the outlook for those securities was still hopeful and that he did not recommend any change. He also suggested that the client borrow on his life insurance to make an investment in a real estate syndication, but this advice was not followed. On Carr's recommendations to another client, Gen. A, certain stocks in his portfolio were sold, and he invested \$2,500 in Aberdeen, and more than \$33,000 in other securities consisting of new issues underwritten by registrant and stocks which it sold as principal.

Other Salesmen

Testimony was received with respect to two other financial planning accounts serviced by non-respondent salesmen which exhibited characteristics similar to those already described. In both accounts the customers were induced, by representations that they would fare much better, to sell securities they owned, worth about \$40,000 and \$19,000, respectively, and in one instance including mutual fund shares, and to buy other mutual fund shares and securities being underwritten or sold as principal by registrant.

c. Conclusions

It is abundantly clear from this record that under the guise of comprehensive "financial planning" encompassing the purchase of varied securities, including listed securities, the above respondents induced customers, who were generally inexperienced and unsophisticated,

^{16/} In his testimony, Haight attempted to make a distinction between the "real estate" referred to in the financial plan and the limited partnership interests in registrant's real estate syndications which he sold to Miss T, and took the position that his characterization of "outstanding quality characteristics" applied to the real estate, not to the security interests in such real estate. We find this distinction unacceptable.

to believe that their best interests would be served by following the investment program designed for them by respondents. In fact, such programs were designed to sell securities that would provide the greatest gain to respondents, rather than to promote the customers' interests; indeed, in some instances, the recommendations were directly contrary to the customers' expressed investment needs and objectives. Moreover, various representations were made to clients to lull them into a feeling of security or to believe that their complaints were unjustified, and thereby sustain their confidence for further recommendations. Such conduct was clearly contrary to the basic obligation of professionals in the securities business to deal fairly with the investing public. 17/

Respondents contend that they did not engage in a scheme to defraud since the evidence does not establish any "agreement" to defraud clients, but, at most, non-fraudulent parallel action. Hodgdon in addition contends that mutual fund sales, which were required by registrant's financial planning approach, may not be treated as "self-enriching" recommendations for purposes of determining whether a scheme to defraud existed, and he and other respondents argue that it is not possible to derive any pattern or draw any inferences from the "handful of cases" considered by the examiner.

There is no merit in these contentions. No express "agreement" is necessary to establish the existence of a scheme to defraud. It is enough that each of the individual respondents knowingly joined or participated in a common undertaking that he knew or should have known was fraudulent. 18/ As we have seen, registrant conducted training programs and staff meetings where instruction was given in the sales techniques which we have described and which were used by respondents to obtain clients and induce them to purchase certain types of securities. Since, as we have concluded, these sales techniques were designed and operated to defraud clients, it is clear that registrant and the individual respondents engaged in a scheme to defraud investors. The fact that mutual fund shares may be considered a desirable investment does not militate against our conclusion that such shares, as well as other securities, were recommended to clients for the primary purpose of obtaining greater compensation for respondents, which was the gist of the scheme we have found. Nor is the finding of a scheme to defraud precluded because of the absence of evidence as to respondents' transactions with clients who were not called as witnesses, with respect to which transactions respondents assert they were misled into not adducing evidence. Such evidence would not have derogated from the pattern of conduct that was established not merely by the testimony of the clients who were called

17/ See Mac Robbins & Co., Inc., 41 S.E.C. 116, 117-19 (1962), aff'd sub nom. Berko v. S.E.C., 316 F.2d 137 (C.A. 2, 1963); J. Logan & Co., 41 S.E.C. 88, 98 (1962). See also Richard N. Cea, Securities Exchange Act Release No. 8662, pp. 8-9 (August 6, 1969): "Although the customers described their financial situations and objectives to these respondent salesmen, the salesmen recommended purchases of securities that were far from commensurate with the investment objectives disclosed by such customers. It was incumbent on the salesmen in these circumstances, as part of their basic obligation to deal fairly with the investing public, to make only such recommendations as they had reasonable grounds to believe met the customers' expressed needs and objectives."

18/ See Blue v. U.S., 138 F.2d 351, 358, 360 (C.A. 6, 1943), cert. denied 322 U.S. 736; Oliver v. U.S., 121 F.2d 245, 249 (C.A. 10, 1941), cert. denied 314 U.S. 66.

as witnesses by the staff, but also by registrant's entire method of operation including its training program. We do not hold that the "cold calls" to prospects and the obtaining of financial information from them were fraudulent per se, and do not interpret the examiner as so holding, as respondents contend he did, but that these were merely elements in the overall fraudulent scheme.

Hodgdon's assertion that there is "a paucity of evidence" implicating him in the fraudulent scheme is particularly untenable. He was in active charge of registrant's business, held weekly officers' meetings at which every aspect of running the firm was discussed, and instituted the "financial planning" program. He assisted in preparing the firm's fraudulent radio advertising, wrote its financial planning brochure, a blatant "come-on" for the unsophisticated investor, and participated in registrant's training program. He attended the firm's staff meetings at which particular securities were recommended to the salesmen for sale to clients and the firm's underwritings, which he selected, were described to the salesmen and their indications of interest taken. Although the radio advertising stated that registrant, while alert for new opportunities, never forgot "long-established stocks," and registrant's ratio system placed blue chips in the middle category of the financial plans drawn up for its clients, he fostered a negative attitude towards recommendations of listed securities. Finally, he treated Mrs. W's financial planning account in the same manner as registrant's salesmen were trained to deal with their clients' accounts, causing her to sell high-grade securities from her portfolio and reinvest the bulk of the proceeds in new and speculative issues that registrant was underwriting. We think it evident that Hodgdon was not only fully cognizant of but directed the fraudulent scheme we have found here.

Finally, respondents contend that the hearing examiner applied improper standards in determining that their securities recommendations to clients were unsuitable. This contention reflects a misapprehension of the examiner's decision. Neither the examiner's conclusions, nor our own, as is evident from the foregoing discussion, rest on a determination that the securities recommended and sold were "unsuitable."

We discuss now materially false and misleading statements made by various respondents in the offer and sale of particular securities.

2. Fraudulent Representations in Sale of Securities

a. Van-Pak, Inc.

Van-Pak, Inc. was organized in 1959 to operate as a freight forwarder of individuals' household goods by the so-called "containerization" method, primarily to and from overseas military installations. In February 1962, pursuant to a registration statement filed under the Securities Act, the company commenced a public offering of 80,000 shares of its common stock at \$5 per share through registrant as underwriter. The State of Virginia refused to allow the issue to be sold there because it found Van-Pak to be insolvent, and Hodgdon so advised registrant's other officers and the salesmen. Registrant had difficulty in disposing of the shares and the offering was not completed until mid-April 1962.

In the offer and sale of Van-Pak stock, Hodgdon represented to a financial planning client that Van-Pak had developed a new type of container, that it had or expected to get government contracts and should therefore grow rapidly, that it expected to start

paying dividends, and that the client would realize a good profit in a short time. Haight told one customer that "when" the price of Van-Pak doubled, she could sell half of her stock and regain her original investment, and represented to another that Van-Pak had defense contracts and should have a bright future. He did not disclose to the latter customer, a Virginia resident, that Van-Pak stock was disqualified from sale in that state because of Virginia's finding of insolvency.

Carr told a customer, in February 1962, that Van-Pak had developed a new type of shipping container for which there was a great demand, and that he felt certain that the stock would appreciate considerably and would "double or better" in six months. The customer asked for a prospectus but Carr told him that it was "fairly urgent" that he make up his mind at once since there was only a very limited number of shares left. The customer then purchased 100 shares. ^{19/} Carr told another customer, a Virginia resident, that Van-Pak was "one of the most promising issues that had come to his attention" and that "it couldn't miss." He did not disclose that Van-Pak could not be sold in Virginia on the ground of insolvency.

Davis stated to one customer that Van-Pak had a new process of storage or moving and expected to get substantial Government contracts that would materially increase the value of its stock, and that it was a "real hot issue" and would be a "terrific" and sound investment that was likely to appreciate 2 or 3 or 4 times in a very short period. He told a second customer of Van-Pak's "revolutionary" moving process and that it expected Government contracts, and another, that Van-Pak had a virtual monopoly on transporting the effects of military people to and from overseas installations. Kibler represented to two customers that Van-Pak had Government contracts for the transportation of household goods in a new type of container developed by it. He told one that the stock was an "excellent buy," and in all probability would increase in price a point or two by late fall and rather rapidly within a year or two. He did not disclose to the other, a Virginia resident, that the stock could not be sold in Virginia on the ground of the company's insolvency. Harper told one financial planning client that Van-Pak had a new system of transportation and that she might be able to sell the stock later at a much higher price, and another that Van-Pak was very progressive with new methods of moving, and looked like it had a very good future. Kitain represented to one customer that the president of Van-Pak had stated there were possibilities of getting a Defense Department contract, and to a second, that Van-Pak stock "had very fine prospects of doubling itself" in about 6 to 9 months.

Respondents' representations were entirely at variance with the picture given in the Van-Pak prospectus. That document stated that the containerization method of shipment was not new in the industry and had not been originated by Van-Pak, that the Military Traffic Management Agency had approved the company's tender of service which, however, merely authorized Van-Pak to compete for business at various military installations, that the company was in competition not only with vanline movers, many of which had larger financial resources, but also with the Military Sea Transport Service, an instrumentality of

^{19/} When the customer received the prospectus, he called Carr and told him he was upset by the financial condition of the company and the fact that the prospectus said nothing about Van-Pak manufacturing containers. Carr replied that he could cancel if he wished, but that it was Carr's judgment that Van-Pak was going to "come out of the red" and do well in the manufacture and sale of its container.

the Government, and that Van-Pak had never paid any dividends nor did it presently intend to do so. The prospectus did not refer to the manufacturing of containers for sale. It merely stated that Van-Pak had leased some of its containers to industry, which operation had not accounted for a significant percentage of total revenue, and that the company had plans to pursue this business further. Finally, the prospectus revealed that Van-Pak was insolvent by an amount exceeding \$100,000. Van-Pak's president testified that his company had no contracts with the Defense Department or any other Government agency and that he never told any representative of registrant that it had or anticipated getting any, and that approval of Van-Pak's tender of service did not guarantee it any income.

Respondents are not aided by their assertion that they were justified in expressing optimism concerning Van-Pak because of its improved business for the five months ending February 1962, the lifting of certain travel restrictions on military dependents by the Government, and a number of favorable factors occurring after the prospectus was written. Such factors could not justify the outright falsehoods and the extravagant predictions which they made, particularly in view of Van-Pak's insolvency. Moreover, we have repeatedly held that price predictions of the kind made here are inherently fraudulent. ^{20/} Nor is there any merit to respondents' contention that the hearing examiner improperly credited the testimony of customers instead of their own. The hearing examiner heard the witnesses, observed their demeanor, and noted that at least ten customers had testified to similar representations being made to them concerning Van-Pak Government contracts. We find nothing in the record to warrant overturning the examiner's determination to credit the customers' testimony.

We find that in the offer and sale of Van-Pak stock, fraud of a serious nature was practiced on registrant's customers, and conclude that, in connection therewith, registrant, together with or willfully aided and abetted by Hodgdon, Haight, Carr, Harper, Kitain, Davis and Kibler, willfully violated the above cited antifraud provisions.

b. U.S. Infrared Corporation

U.S. Infrared Corporation ("USI") was incorporated in August 1960 to develop and manufacture an infrared heat detector for use chiefly in spotting railroad "hot boxes." Amann, then a vice-president of registrant, was one of the promoters of USI and sought to interest Hodgdon in having registrant undertake a private offering of the company's stock. Hodgdon investigated the situation and was unimpressed, and he, Haight and other officers of the firm sought to dissuade Amann from proceeding with this venture. However, upon Amann's representation that he had made a commitment to obtain financing for USI, Hodgdon agreed to allow a "private placement" of the company's stock through registrant, although he issued a memorandum to all salesmen stating that USI was a gross speculation and directing any of them who wished to offer USI stock to their clients to tell them that registrant regarded it as too speculative to merit approval at that time. Between August 30 and October 7, 1960, registrant sold 45,430 shares of USI stock at \$1.10 per share to 18 customers. Thereafter, in July 1961, USI solicited its

^{20/} See, e.g., Richard N. Cea, Securities Exchange Act Release No. 8662, p. 6 (August 6, 1969); Kennedy, Cabot & Co., Inc., Securities Exchange Act Release No. 8817, p. 6 (February 16, 1970).

stockholders, by a letter and accompanying memorandum which were signed by Amann as both chairman of USI's executive committee and vice-president of registrant, to purchase USI convertible debentures. When Hodgdon saw these documents, he sent out telegrams stating that Amann had not been authorized to sign the documents on behalf of registrant and that registrant disavowed them, and discharged Amann. 21/

In the stock offering, Amann represented to one customer that USI's device was being well received by the railroads, that the results of their tests were excellent, and that registrant might subsequently underwrite a public offering of USI stock at \$4 per share. This customer was not told of registrant's unfavorable opinion of USI, and he testified that he would not have bought the stock if he had been told. Amann stated to another customer that USI's device had tremendous potential, and that he was being given an opportunity to buy at a low price before USI made a public offering through registrant. A third investor, who purchased a \$10,000 convertible debenture in July 1961, was told by Amann that he had received a "fantastic" report on USI's device by a group of engineers that included foreigners, which would give the product a potential foreign as well as a domestic market, that it was a good time to buy since there was a large potential market for the product, and that Amann visualized the common stock into which the debenture was convertible as "really rising." Amann did not inform the investor that by then USI was in desperate financial straits.

Kitain told a customer during the private stock offering that an investment in USI would be profitable, and that the customer would be coming in on the ground floor since USI would go public at a higher price later on.

There was no reasonable basis for the representations made. USI's infrared device was never placed in production or successfully marketed. Amann admitted that every time the device was shown to the railroads, at whom it was primarily aimed, it was found to require further refinement. 22/ USI never made a profit and experienced continual losses. In September 1961, it became inactive for lack of funds to carry on its business. There was no justification for representations that a highly favorable engineering report had been received, that USI would be profitable, that there would be a public offering through registrant as underwriter, or that the offering price would be higher than the current sales price.

We conclude that in the offer and sale of USI stock, registrant, together with or willfully aided and abetted by Amann and Kitain, willfully violated the above cited antifraud provisions.

c. Paragon Electrical Manufacturing Corporation

Paragon Electrical Manufacturing Corporation was incorporated in 1960 to develop and market a reusable crimp-type wire connector and its related tool. In January 1961, registrant undertook to place privately 20,000 shares of Paragon stock at \$5.50 per share.

21/ Amann was reemployed by registrant as a salesman in October 1961.

22/ A USI progress report of February 24, 1961 stated that sales visits to two railroads indicated that its heat detector was not sufficiently engineered for any particular applications to be of great value. USI eventually obtained orders for two of its devices, but they were never delivered because the company lacked the production capability.

Carr represented to a customer that Paragon had agreements with General Electric Co. and Westinghouse Electric Co. for the distribution of its wire connector, that the customer would make a very nice profit after the stock was offered publicly, and that there was even talk of a 3 for 1 stock split prior to such offering. There was no basis for these representations. Although the two named electric companies purchased some connectors from Paragon, they had no distribution agreements with it. Paragon never made a public offering of its stock and, while the possibility of such an offering may have been discussed, there was no justification for the statement made to the customer which assumed it would take place. Nor was a stock split ever contemplated.

We conclude that in the offer and sale of Paragon stock, registrant, together with or willfully aided and abetted by Carr, willfully violated the cited antifraud provisions.

d. Apache Canadian Gas and Oil Program 1961

Registrant, beginning in August 1961, participated in a registered offering of 100 units of Apache Canadian Gas and Oil Program 1961 at \$5,000 per unit. The proceeds of the offering were to be used for the acquisition, exploration and development of gas and oil leaseholds in Canada.

Harper sold an Apache unit to Mrs. D, a financial planning client. Mrs. D soon became dissatisfied with her investment and tried several times to get Harper to sell it for her, but Harper dissuaded her, stating with strong emphasis that it would be a grave error to do so and that he knew of anxious buyers for the units. In his February 1962 report to Mrs. D on the status of her account, Harper listed her investment in Apache at \$7,500 (representing the cost price of \$5,000 for one unit and assessments of \$2,500) followed by a plus sign, with the notation that such figure might be considered an undervaluation since bids had run as high as \$25,000 per unit. He also told Mrs. D that a unit would be valued higher than \$25,000. In August 1964, he represented to Mrs. D that the value of her investment was \$35,000, advising her that several buyers "would pay that price," and that it would be "a great mistake" to sell. Harper made similar lulling representations to Dr. B, a financial planning client, who had purchased an Apache unit for \$12,050 subsequent to the offering. In a January 1963 report to Dr. B, Harper valued the unit at \$22,000, and in February 1964 he represented the value to be \$30,000 with a potential worth of \$100,000.

Harper asserted that he obtained his valuation figures from the corporate sponsor of the Apache program. An officer of the sponsor testified, however, that there was no basis for the figures which Harper supplied to his clients. It is obvious from Harper's testimony, moreover, that the figures he used were the sponsor's estimates of total future income per unit. We conclude that registrant, together with or willfully aided and abetted by Harper, willfully violated the above antifraud provisions.

e. Data Processing Corporation of America

Davis, in connection with a transaction in 1961 in the stock of Data Processing Corporation of America ("DPCA"), which had been organized two years earlier to establish and operate data processing service centers, wrote to his customer that there would shortly be a public offering of the stock at a price considerably more than the \$3.50 per share paid by him and that market interest should make the price behave favorably after the public offering.

There was no reasonable basis for these representations. As Davis admittedly was aware, a DPCA underwriting was only in the talking stage and there was no assurance that there would be a public offering. We conclude that Davis willfully violated the antifraud provisions of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. We make no adverse finding as to registrant in this respect because Davis' transactions, like other transactions in DPCA stock by Amann, Kitain, and another salesman, were concealed from registrant and not recorded on its books. The participation of Amann, Kitain, and Davis in sales of the stock on behalf of DPCA in alleged violation of the registration provisions of the Securities Act is treated below.

Sales of Unregistered Securities

The examiner found that the offer and sale of unregistered USI, DPCA and Paragon stock discussed above did not qualify for the claimed "private offering" exemption from registration, and that, accordingly, registrant and the various respondents who participated willfully violated the registration provisions of the Securities Act.

Respondents assert that the investors in these three stocks understood the nature of the issuers' businesses and the speculative and venture capital quality of their investment, and that under the circumstances the offerings qualified for the exemption. They additionally contend that they relied on a 1935 Commission interpretation, published in the Federal Register in 1946 and assertedly applicable at the time of the offerings in question, which they claim exempted from registration all offerings, including the ones in question, made to less than 25 persons.

We agree with the examiner that there was no basis for the claimed exemption. The USI, DPCA and Paragon offerings were made to various inadequately informed persons who clearly did not occupy a relationship to the issuers giving them access to the same kind of information that a registration statement under the Securities Act would have supplied, nor did they possess such information. Under such circumstances, as held by the Supreme Court in S.E.C. v. Ralston Purina Co., 23/ the small number of offerees is not determinative of whether an offering is private. And, as one Court has recently pointed out, "Sophistication is not a substitute for 'access to the kind of information which registration would disclose.'" 24/

Aside from the fact that the landmark Ralston Purina decision was issued in 1953, long before the transactions at issue here, respondents' asserted reliance on the interpretation published in the 1946 Federal Register was wholly misplaced since it was based on an excerpt taken out of context. That interpretation specifically states that "the determination of what constitutes a public offering is essentially a question of fact, in which all surrounding circumstances are of moment. In no sense is the question to be determined exclusively by the number of prospective offerees." 25/ Nor was Amann relieved of responsibility

23/ 346 U.S. 119 (1953). See also Gilligan, Will & Co. v. S.E.C., 267 F.2d 461 (C.A. 2, 1959), cert. denied 361 U.S. 896.

24/ U.S. v. Custer Channel Wing Corporation, 376 F.2d 675, 678 (C.A. 4, 1967), cert. denied 389 U.S. 850.

25/ Securities Act Release No. 285 (1935), 11 Fed. Reg. 10952 (1946).

by the reliance he assertedly placed on the advice of counsel and Hodgdon. 26/

Hodgdon approved the sale of the USI and Paragon offerings through registrant and reviewed lists of prospective offerees which he required the salesmen to submit to him. He should have been aware that no private offering exemption was available. 27/ We conclude that registrant and Hodgdon, together with Amann and Kitain in the offer and sale of USI stock, and with Carr in the offer and sale of Paragon stock, willfully violated Sections 5(a) and 5(c) of the Securities Act, and that Amann, Kitain and Davis willfully violated those provisions in the offer and sale of DPCA stock.

Other Violations

a. False Records

When Hodgdon learned that the State of Virginia had banned sales of Van-Pak stock, he told registrant's salesmen that, in the opinion of counsel, sales could be made to Virginia residents provided they were solicited outside the state, and that, if possible, legitimate non-Virginia business addresses for such customers should be used for purposes of such transactions, since it was desired to have "as little occasion as possible to irritate anybody in the Virginia Securities Commission." Where an address out of the State could not be used, the salesmen and registrant's clerical staff were instructed to mark order tickets and confirmations "unsolicited." Haight and Adam admitted marking order tickets in accordance with this instruction. It is clear that confirmations of transactions with Virginia residents who were solicited outside that state but had only a Virginia address were marked "unsolicited." In addition, the record contains several instances where Virginia residents who were solicited to purchase Van-Pak stock in Virginia received confirmations similarly marked. The record does not show that Hodgdon, Haight or Adam knew or should have known of these latter instances.

Hodgdon argues that the notation "unsolicited" was merely "a shorthand expression" for "not solicited in Virginia" and that inclusion of the term "was of no relevance from the standpoint of the Commission's legitimate interests." We disagree. Without taking any position on whether registrant's sales complied with Virginia law, we think it clear that the use of the term "unsolicited" where the order was in fact solicited constituted a false entry which could hamper this Commission in its investigatory functions.

We conclude that registrant, willfully aided and abetted by Hodgdon, Haight and Adam with respect to sales solicited outside of Virginia, made false entries on its records in willful violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

26/ Gearhart & Otis, Inc., Securities Exchange Act Release No. 7329, p. 34 (June 2, 1964), aff'd 348 F.2d 798 (C.A.D.C. 1965); Mark E. O'Leary, Securities Exchange Act Release No. 8361, p. 7 (July 25, 1968).

27/ See Century Securities Company, Securities Exchange Act Release No. 8123, p. 9 (July 14, 1967), aff'd sub nom. Nees v. S.E.C., 414 F.2d 211, 220 (C.A. 9, 1969). We reject Hodgdon's contention that a violation of the registration provisions cannot be found as to him because the more definite statement of charges furnished by the Division did not name him as having "singly" violated them. That statement did not affect the sufficiency of the allegation in the order for proceedings that he committed such violations "in concert with" others.

b. Failure to Amend Application for Broker-Dealer Registration

During the relevant period, registrant's application for broker-dealer registration was not amended to reflect the election of certain officers and directors. Registrant argues that its failure to amend was inadvertent, and therefore not willful, and Hodgdon points to his testimony that he had delegated responsibility for preparing such amendments to his executive secretary and was unaware that they were not timely filed.

A finding of willfulness within the meaning of Section 15(b) of the Exchange Act does not require a finding of intention to violate the law. Hodgdon was responsible for registrant's compliance with amendment requirements. His delegation of responsibility to a ministerial employee did not relieve him of his obligation to make certain that appropriate filings were made. 28/ We conclude that registrant, willfully aided and abetted by Hodgdon, willfully violated Section 15(b) of the Exchange Act and Rule 15b3-1 thereunder.

c. Failure to Transmit Funds Promptly

Rule 15c2-4 under the Exchange Act provides in pertinent part that it is a "fraudulent, deceptive or manipulative act or practice" within the meaning of Section 15(c)(2) of the Act for a broker or dealer participating in a distribution of securities to accept the proceeds thereof unless "promptly transmitted" to the persons entitled thereto.

Registrant was the underwriter on a "best efforts" basis of an offering of stock of Southeastern Mortgage Investors Trust. During the period January 20 to February 28, 1964, registrant transmitted the proceeds of sales of Southeastern stock to the issuer after varying periods of time. Such transmittal, in our view, was not prompt at least with respect to 46 sales where it occurred 11 to 15 days after receipt of the funds. 29/ Accordingly, we conclude that registrant willfully violated Section 15(c)(2) of the Exchange Act and Rule 15c2-4 thereunder.

Other Matters

Respondents pursue various contentions that we previously considered and rejected on interlocutory appeals from rulings of the hearing examiner. They argue that we are precluded from imposing sanctions upon them by reason of prejudgment, chiefly because of the discussion of certain of registrant's activities in the 1963 Report of

28/ See Sterling Securities Company, 39 S.E.C. 487, 495 (1959); Peoples Securities Company, 39 S.E.C. 641, 645 (1960); Alfred Miller, Securities Exchange Act Release No. 8012, pp. 6-7 (December 28, 1966).

29/ Contrary to registrant's contention, we consider that it received payment for a purchase upon receipt of a customer's check, not on the settlement date when it merely made the bookkeeping entry. In cases, however, where the customer had a credit balance in his account sufficient to cover the purchase price, we have treated payment as having been received by registrant on the settlement date, when the account was charged with payment.

Special Study of Securities Markets; 30/ that respondents' request for production of Special Study memoranda by or between the Commission and its staff relating to respondents was improperly denied; and that we wrongfully rejected their requests to make these proceedings private and to grant oral argument on such requests. These arguments are without merit.

Respondents' contention with respect to prejudgment, if it prevailed, would have the effect of immunizing from administrative proceedings not only every firm named in the Special Study as to which an adverse comment was made, but also every unnamed firm whose activities were considered in making an adverse comment. There is no basis for such a result, and it certainly was not contemplated by the Congress when, in Section 19(d) of the Exchange Act, it expressly directed the investigation to ascertain the adequacy of investor protection in the securities markets which resulted in the Special Study report. Our letter transmitting that report to the Congress made it clear that the investigation which was made and the writing of the report were the work of a separate staff established within this Commission under the supervision of a director appointed for that purpose, and while the Commission "worked very closely" with the staff and went over its report, "the judgments, analyses and recommendations in the report [were] those of the [staff] and not the Commission." 31/ Even assuming that consideration of the report played some part in the much later determination to institute these proceedings against respondents, 32/ this would in no sense constitute prejudgment of the issues raised herein. 33/ The Commission, in carrying out its statutory responsibilities, could hardly be required to ignore the report, the consideration of which would, as recognized by the Administrative Procedure

30/ H. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess., 109-110, 261-2 (1963). The Special Study, after observing that specialization is "in many respects desirable," cited registrant as an example of a broker-dealer who specializes but projects an image to the public of "equal willingness to sell, and equal knowledge about, securities other than those within his specialty." Noting that the firm recommended investments by its customers primarily in real estate syndications, a number of which were promoted by the firm, and mutual funds, with one of which the proprietor of the firm was affiliated, the Special Study stated that "in such instances, specialization strains the broker's obligation to deal fairly with his customer and strains it even further where a relationship of trust and confidence has been developed."

31/ Special Study, supra, p. IV.

32/ Although the report was submitted to Congress in 1963, these proceedings were not instituted until 1966 after a further investigation, initiated in late 1964, had been made by our staff. The allegations in the order for proceedings and the evidence in the record cover a period of time subsequent to the report's submission, and include matters that were not even mentioned in the report.

33/ See San Francisco Mining Exchange v. S.E.C., 378 F.2d 162, 167 (C.A. 9, 1967). See also Federal Trade Commission v. Cement Institute, 333 U.S. 863 (1948); Pangburn v. C.A.B., 311 F.2d 349 (C.A. 1, 1962).

Act ("APA"), be entirely consistent with the dual functions of a prosecutory and adjudicatory nature exercised by the Commission. The Special Study memoranda, being investigatory in character, were properly kept confidential. Finally, it may be noted that none of the present Commissioners was associated with this Commission at the time the Special Study report was prepared and submitted to Congress, and that our decision herein is based solely on the record made by the parties before the hearing examiner. 34/

The determination of whether a proceeding shall be public or private rests within our discretion. 35/ In this case we considered that, in view of the gravity of the charges made against registrant and its management and salesmen, their desire for privacy was outweighed by the general public interest and the interest of investors. 36/ These considerations were still applicable when respondents, three months after the proceedings were instituted and after hearings had begun, requested that all further proceedings be kept private. 37/ And, in the absence of a statutory requirement, respondents were not

34/ As further "evidence" of prejudgment, respondents point to the press release issued when these proceedings were instituted. That release, however, made it clear that the violations were alleged, not found, that the allegations were those of the staff, not the Commission, and that a hearing would be held to determine whether the alleged violations had occurred, and, if so, whether any remedial action should be ordered. Securities Exchange Act Release No. 7833 (March 3, 1966). Cf. Federal Trade Commission v. Cinderella Career and Finishing Schools, Inc., 404 F.2d 1308, 1312-15 (C.A.D.C. 1968).

35/ Section 22 of the Exchange Act provides that "hearings may be public," and Rule 11(b) of our Rules of Practice states that all hearings with certain exceptions not applicable here "shall be public unless otherwise ordered by the Commission."

36/ See. R. A. Holman & Co., Inc., Securities Exchange Act Release No. 7770, p. 13, n. 25 (December 15, 1965), aff'd 366 F.2d 446 (C.A. 2, 1966). In J. H. Goddard & Co., Inc., 41 S.E.C. 964, 966 (1964), in setting forth some of the considerations which favor public proceedings, we stated that such proceedings enable investors to institute causes of action against broker-dealers promptly before any of their witnesses have become unavailable, may encourage persons to come forward to testify or to request leave to be heard or to intervene, may alert investors to certain activities of broker-dealers, and inform the industry that the Commission has instituted action with respect to such activities.

37/ Respondents also complain that they were not furnished with a statement they requested of the number of private Commission proceedings within the year prior to institution of the instant proceedings and the nature of the charges involved in such proceedings. Aside from the fact that the request does not appear to have been properly presented to us because it was raised for the first time in a brief seeking review of an examiner's ruling which did not relate to such request, the information sought would not have disclosed the bases for our action making the other cases private.

entitled to oral argument on the issue of public or private proceedings. 38/

We also reject respondents' further contentions that the Division improperly suppressed evidence favorable to their defense, that these proceedings were unfairly based upon "sweeping allegations," and that "undue delay" in instituting them denied respondents due process and violated the APA.

Respondents cite Brady v. Maryland 39/ for the proposition that prior to the hearings the Division was required to furnish a list of all prospective witnesses, oral and written statements taken from them, summaries or memoranda of staff interviews with such witnesses, and copies of all completed questionnaires received from them. The Brady case held that suppression by the prosecution of material evidence favorable to an accused who has requested it is a denial of due process. It did not, however, authorize a wholesale "fishing expedition" into investigative material such as respondents attempted to embark upon here. 40/ The Division was not required to furnish the names of its prospective witnesses to respondents. 41/ And statements of staff witnesses obtained in the course of an investigation are confidential except that after such witnesses' direct testimony in the principal proceedings, any respondent may request and obtain production of such statements for the purpose of impeaching their testimony. 42/ The charges against respondents were necessarily broad since they encompassed registrant's whole method of operation. However, respondents' motion for a more definite statement of such charges was in large part granted, and a vigorous defense was presented to all of the allegations raised.

38/ Neither Section 6 of the APA (5 U.S.C. § 555(b)) which respondents cite nor the statutes administered by us contain such a requirement. See Morgan v. United States, 298 U.S. 468, 481 (1936); F.C.C. v. WJR, 377 U.S. 265, 281 (1949); McGraw Electric Co. v. United States, 120 F. Supp. 354, 358-9 (E.D. Mo., 1954), aff'd 348 U.S. 804 (1954).

39/ 373 U.S. 83 (1963).

40/ See Harris, Clare & Co., Inc., Securities Exchange Act Release No. 8004, p. 4 (December 9, 1966).

41/ Armstrong, Jones & Co. v. S.E.C., 421 F.2d 359, 364 (C.A. 6, 1970), cert. denied 398 U.S. 958, aff'g Armstrong, Jones & Co., Securities Exchange Act Release No. 8420, p. 15 (October 3, 1968); Diugash v. S.E.C., 373 F.2d 107, 110 (C.A. 2, 1967), aff'g F.S. Johns & Company, Inc., Securities Exchange Act Release No. 7972, pp. 15-16 (October 10, 1966); Richard N. Cea, Securities Exchange Act Release No. 8662, p. 12 (August 6, 1969).

42/ See Rule 11.1 of the Commission's Rules of Practice which codified the Commission's practice with respect to pre-hearing statements of staff witnesses, following the decision in Jencks v. U.S., 353 U.S. 657 (1957). See R.A. Holman & Co., Inc., Securities Exchange Act Release No. 7770, p. 12, n. 24 (December 15, 1965), aff'd 366 F.2d 446, 455 (C.A. 2, 1966).

Respondents assert that although this proceeding was not instituted until March 1966, the Division, as a result of the investigation conducted by the Special Study staff, had all of the information it needed by 1963. As previously noted, however, the allegations in these proceedings and the evidence introduced cover a period extending until mid-1964, and the Division asserts it did not begin to gather the necessary evidence until the Commission issued its investigative order of November 24, 1964. In any event, the law is clear that the doctrine of laches or estoppel cannot be invoked against the Government acting in a sovereign capacity to protect the public interest. ^{43/} Respondents' position is not supported by their citation of Section 6 of the APA. ^{44/} Moreover, if, as respondents assert, they considered that the memory of any witnesses who testified against them had dimmed, they had ample opportunity to explore their testimony on cross-examination. And the lapse of time did not appear to hamper the recollection of the respondent-witnesses. ^{45/}

Public Interest

In view of the willful violations we have found on the part of registrant and the individual respondents other than Baskin, we must determine what sanctions are necessary or appropriate in the public interest. With respect to Baskin, we were unable to conclude, on the record before us, that he participated in any of the violations found, and accordingly the proceedings with respect to him will be dismissed. ^{46/} As previously mentioned, the hearing examiner determined to suspend registrant from the NASD and PBW for four months, and to bar Hodgdon, Haight, Adam, and Harper. In addition, he concluded that Kitain and Davis should each be suspended from association with any broker or dealer for one year, and Carr and Kibler for ten months and five months, respectively, and that Amann should be barred with the proviso that upon an appropriate showing he might become associated with a broker-dealer in a supervised capacity after nine months.

^{43/} See Richard N. Cea, Securities Exchange Act Release 8662, p. 11 and cases cited in n. 18 (August 6, 1969).

^{44/} That section merely provides: "With due regard for the convenience and necessity of the parties or their representatives and within a reasonable time, each agency shall proceed to conclude a matter presented to it."

^{45/} Various respondents also contend that the examiner's initial decision was not in conformity with the requirements of Section 8 of the APA (5 U.S.C. § 557(c)) in that it failed to make appropriate findings with respect to credibility and "other matters," or to rule on each proposed finding and conclusion. Our review of that decision satisfies us that it comports with the standards set forth in the APA. See Stauffer Laboratories, Inc. v. F.T.C., 343 F.2d 75, 81-2 (C.A. 9, 1965); Covle Lines, Inc. v. U.S., 115 F. Supp. 272, 276 (E.D. La., 1953); Norman Pollisky, Securities Exchange Act Release No. 8381, p. 10 (August 13, 1968). We note further as to the examiner's credibility determinations that, aside from his findings with respect to representations made in the sale of Van-Pak stock which we have discussed above, respondents raise specific objections to only three such determinations. None of the evidence as to which those determinations were made is the basis for any of our findings.

^{46/} Our references hereinafter to "respondents" will not include Baskin.

Various factors have been urged by respondents as warranting the imposition of no sanction or a lesser sanction than was imposed by the examiner. Among other things, they variously assert that the sanctions assessed are "grossly disproportionate" to those imposed for similar offenses in non-"boiler-shop" cases, that to assess sanctions for conduct that occurred so long ago would be "per se punitive," and that there is no evidence in this record that respondents are not now or have not been for a number of years "in total compliance with the law." At the least, it is urged these proceedings should be remanded to the examiner to receive the additional evidence "timely proffered" as to "compliance with the law" since the record was closed.

The remedial action which is appropriate in the public interest depends upon the facts and circumstances of each particular case and cannot be precisely determined by comparison with action taken in other cases. 47/ In determining the appropriateness of a particular sanction, we consider, among other things, the nature, extent and seriousness of the violations found, whether the firm's officials participated in the misconduct, and the ever-developing standards of the securities industry, as well as any mitigating circumstances presented. The cases cited by respondents to show discrimination in the imposition of sanctions do not support their position, and a number of them involved settlements. In settlement cases, where as a rule there is no admission of violations, we take into account pragmatic considerations such as the avoidance of time- and manpower-consuming adversary proceedings.

The imposition of sanctions here is no less remedial because of the lapse of time since the misconduct occurred. Respondents' argument would in effect require the dismissal of broker-dealer proceedings in any case where an extensive investigation was made, a large number of respondents were involved and the many issues raised were vigorously litigated. The Division was under no duty to adduce evidence that respondents had not complied with the securities laws since the alleged violations occurred. As to respondents' request for a remand of the proceedings so as to adduce evidence of compliance, we note that the evidence referred to had been offered by registrant and Haight merely to show that after the hearings registrant had added supervisory personnel, installed new equipment, and adopted new policies and procedures. We reaffirm our previous ruling which denied such proffer. 48/

Various other factors have also been cited by the examiner or urged by various respondents: the damage suffered as a result of unfavorable publicity; measures adopted by registrant to prevent a recurrence of the alleged violations; the fact that Hodgdon has left

47/ See Winkler v. S.E.C., 377 F.2d 517, 518 (C.A. 2, 1967); Dlugash v. S.E.C., 373 F.2d 107 (C.A. 2, 1967); Hiller v. S.E.C., 429 F.2d 856 (C.A. 2, 1970); Martin A. Fleishman, Securities Exchange Act Release No. 8002, p. 5 (December 7, 1966); 2 Loss, Securities Regulation, (2d ed. 1961), pp. 1323-24.

48/ In our prior ruling we noted that we had in prior cases denied requests to reopen hearings for such purpose. Norris & Hirshberg, Inc., 22 S.E.C. 558, 559 (1946); Isthmus Steamship & Salvage Co., Inc., Securities Exchange Act Release No. 7476, p. 5 (December 2, 1964); Crow, Brouman & Chatkin, Inc., Securities Exchange Act Release No. 7876, p. 2 (April 29, 1966). We further stated the requested reopening would be an inappropriate departure from orderly procedures and an unwarranted prolongation of the proceedings, particularly since the evidence sought to be introduced appeared essentially cumulative.

the securities business with no intention of returning; 49/ Hodgdon's direction of other individual respondents; the fact that registrant's employment of Davis, Kibler, Carr, Adam, Harper, and Kitain was their first as registered representatives; the fact that this was the first disciplinary proceeding against the individual respondents; and Amann's belief in the merits of the USI and DPCA offerings and his investment of personal and family funds in them.

We conclude that the various mitigative factors cited are insufficient to overcome the serious fraud and other violations of the respondents. We agree with the hearing examiner's determination that Hodgdon, Haight, Adam and Harper should be barred. We find, however, that the sanctions which the examiner imposed on registrant and the other individual respondents were inadequate in the public interest.

As we have seen, registrant, various of its officers with the exception of Amann, and the other individual respondents participated in a nefarious scheme to defraud financial planning clients and betrayed the trust clients were induced to place in them. Although we have not found that Amann participated in that scheme, he made serious misrepresentations in the sale of USI stock and was to a major degree responsible for the violations of the registration requirements that occurred with respect to the USI and DPCA stock offerings. In addition to Amann, moreover, registrant and the individual respondents other than Adam made fraudulent representations to customers in the offer and sale of various securities, and registrant, Hodgdon, Carr, Kitain and Davis violated the registration provisions of the Securities Act. Although Hodgdon has left registrant, its so-called new management consists of Haight, Carr, Adam, Harper and Kitain, each of whom owns 10% or more of the firm's stock.

We conclude that registrant's broker-dealer registration should be revoked, that it should be expelled from NASD and PBW membership, and that Carr, Kitain, Davis, Kibler, and Amann as well as the other individual respondents should be barred. In our judgment the sanctions we are imposing are appropriate in the public interest notwithstanding that we have not affirmed all of the adverse findings made by the hearing examiner with respect to various of the respondents. 50/

An appropriate order will issue.

By the Commission (Commissioners OWENS, SMITH, NEEDHAM and HERLONG).

Orval L. DuBois
Secretary

49/ In July 1964, Hodgdon ceased participation in the day-to-day management of registrant and sold a portion of his shares divesting himself of control. It appears that his association with the firm was completely terminated in December 1965. Haight has been president, a director, and the major stockholder of registrant since July 1964.

50/ Among other things, we have not sustained the examiner's findings that fraudulent representations were made with respect to the rate of return on certain real estate securities offered and sold by respondents.

The exceptions to the initial decision of the hearing examiner are overruled to the extent that they are inconsistent with our decision and sustained to the extent that they are in accord therewith.

ADMINISTRATIVE PROCEEDING
FILE NO. 3-533

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
February 19, 1971

In the Matters of

HAIGHT & CO., INC.
(formerly HODGDON & CO., INC.)
1101-17th Street, N.W.
Washington, D.C.

(8-8427)

A. DANA HODGDON
JAMES F. HAIGHT
BURTON KITAIN
W. LYLES CARR, JR.
DAVID M. ADAM, JR.
JAMES W. HARPER III
HOMER E. DAVIS
ROBERT F. KIBLER
LOUIS S. AMANN
HARVEY A. BASKIN

ORDER
IMPOSING
REMEDIAL
SANCTIONS

Securities Exchange Act of 1934 -
Sections 15(b), 15A and 19(a)(3)

Proceedings having been instituted pursuant to Sections 15(b), 15A and 19(a)(3) of the Securities Exchange Act of 1934 to determine what, if any, remedial action is appropriate with respect to the above-captioned respondents;

Hearings having been held after appropriate notice, the hearing examiner having filed an initial decision, the Commission having granted the petitions for review that were filed as to certain issues and ordered review of such decision on its own motion with respect to all other issues before the examiner, briefs having been filed, and oral argument having been heard;

The Commission having this day issued its Findings and Opinion; on the basis of said Findings and Opinion

IT IS ORDERED that the registration as a broker and dealer of Haight & Co., Inc. be, and it hereby is, revoked; that Haight & Co., Inc. be, and it hereby is, expelled from membership on the Philadelphia-Baltimore-Washington Stock Exchange and in the National Association of Securities Dealers, Inc.; and that A. Dana Hodgdon, James F. Haight, W. Lyles Carr, Jr., David M. Adam, Jr., James W. Harper III, Burton Kitain, Louis S. Amann, Homer E. Davis, and Robert F. Kibler be, and they hereby are, barred from being associated with any broker or dealer.

IT IS FURTHER ORDERED that these proceedings with respect to Harvey A. Baskin be, and they hereby are, dismissed.

By the Commission.

Orval L. DuBois
Secretary

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos.
71-1136
23,244
23,246

United States Court of Appeals
for the District of Columbia Circuit

FILED 3 12 1971

Morton Paulson
CLERK

HAIGHT & CO., INC., ET AL.,

Petitioners,

-v-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

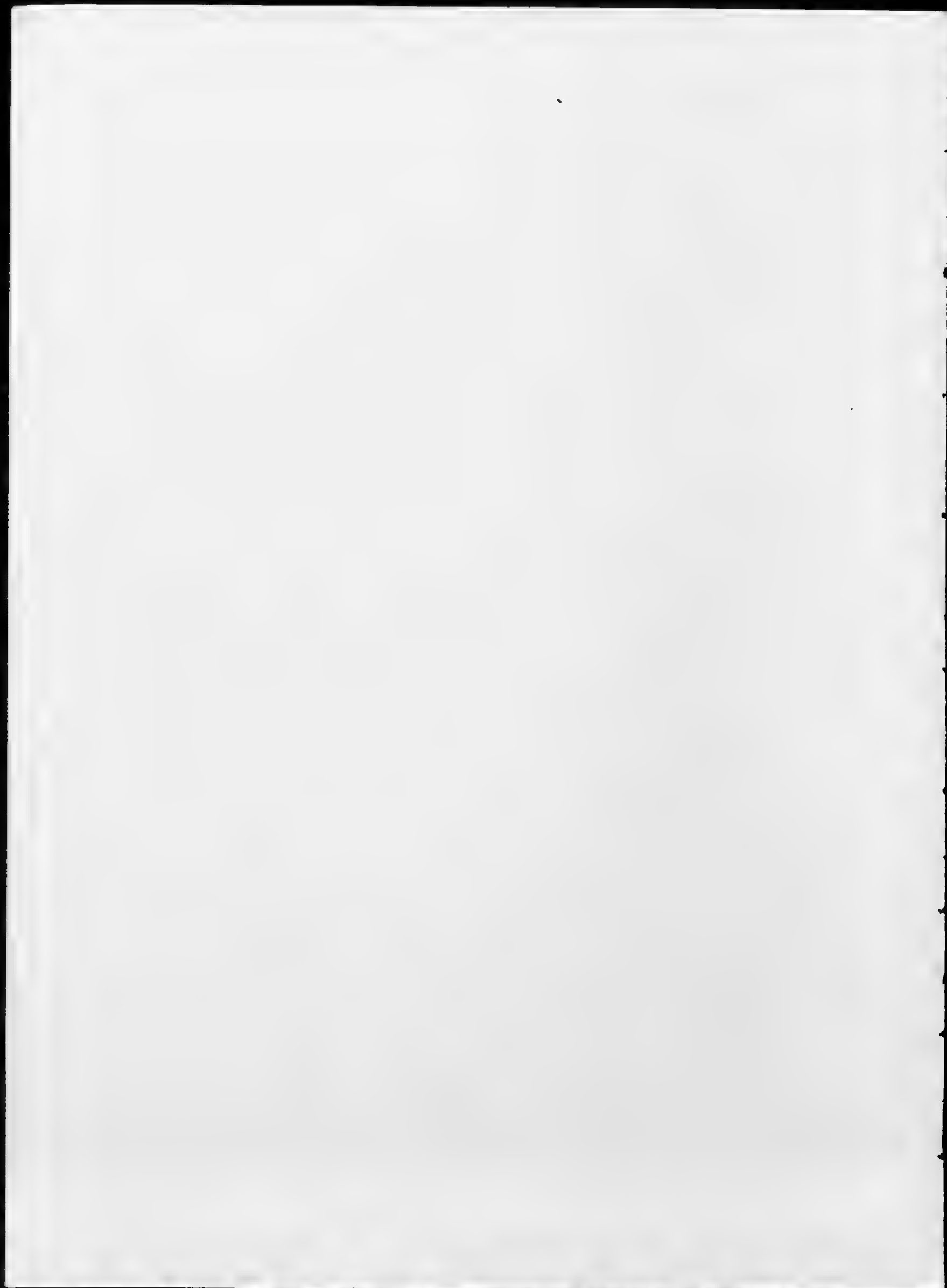
BRIEF FOR PETITIONERS

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Of Counsel



STATEMENT OF THE ISSUES
PRESENTED FOR REVIEW

1. Is it a violation of the federal securities law for a seller of securities to persuade a client to sell one security and purchase another security on which the seller will realize a commission higher than the New York Stock Exchange agency commission rate, where:

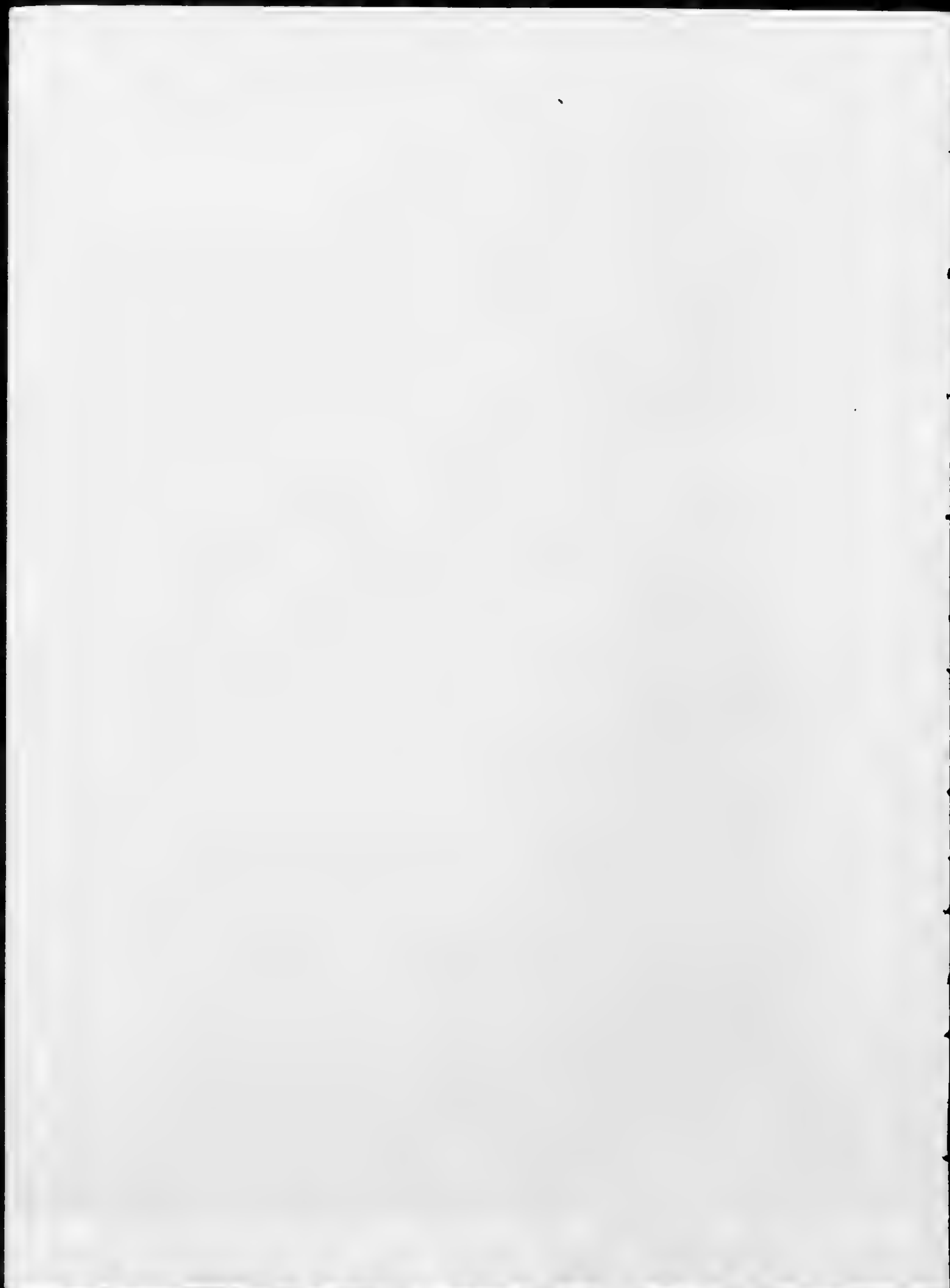
- (a) the amount of that commission is disclosed; and
- (b) the seller of the securities reasonably believes that the client will be benefited by the transaction; or
- (c) the transaction, in fact, benefits the client and/or is in accord with his stated objectives and desires?

2. Is the Commission's conclusion that respondents had employed financial planning merely as a guise with which to defraud their customers supported by substantial evidence and adequately articulated findings of fact?

3. May the Commission permissibly infer from an examination of 19 customer cases out of 10,000 that respondents had engaged in a general course of business conduct which defrauded their customers, particularly where the Examiner prevented respondents from adducing evidence which was relevant to their general business conduct?

4. Was there substantial evidence that each respondent had knowingly agreed to participate in a course of fraudulent conduct?

5. Did the Commission err as a matter of law in concluding that respondents' 1960-1961 securities offerings to less than 25 persons were not exempt from the registration requirements of the Securities Act of 1933?



6. Did the Commission fail to make findings, which under the Commission's interpretation of its "private offering" regulation, were essential to a determination of whether respondents' 1960-1961 securities offerings were exempt from the registration requirements of the Securities Act of 1933?

7. Did the Examiner and the Commission commit legal error by failing to make credibility findings on the conflicting evidence as to whether respondents had made misrepresentations incident to the sale of securities?

8. As a matter of law, can respondents be found to have made misrepresentations incident to the sale of Van Pak shares when there was a reasonable basis for the statements which they made?

9. Is the Commission's opinion and order in this proceeding tainted by prejudgment?

10. Were respondents denied fair notice and opportunity to defend by virtue of the overbroad charges, the denial of particularization, the burdensome hearing, the abandonment of charges, and the change in the principal theory of violation in this case?

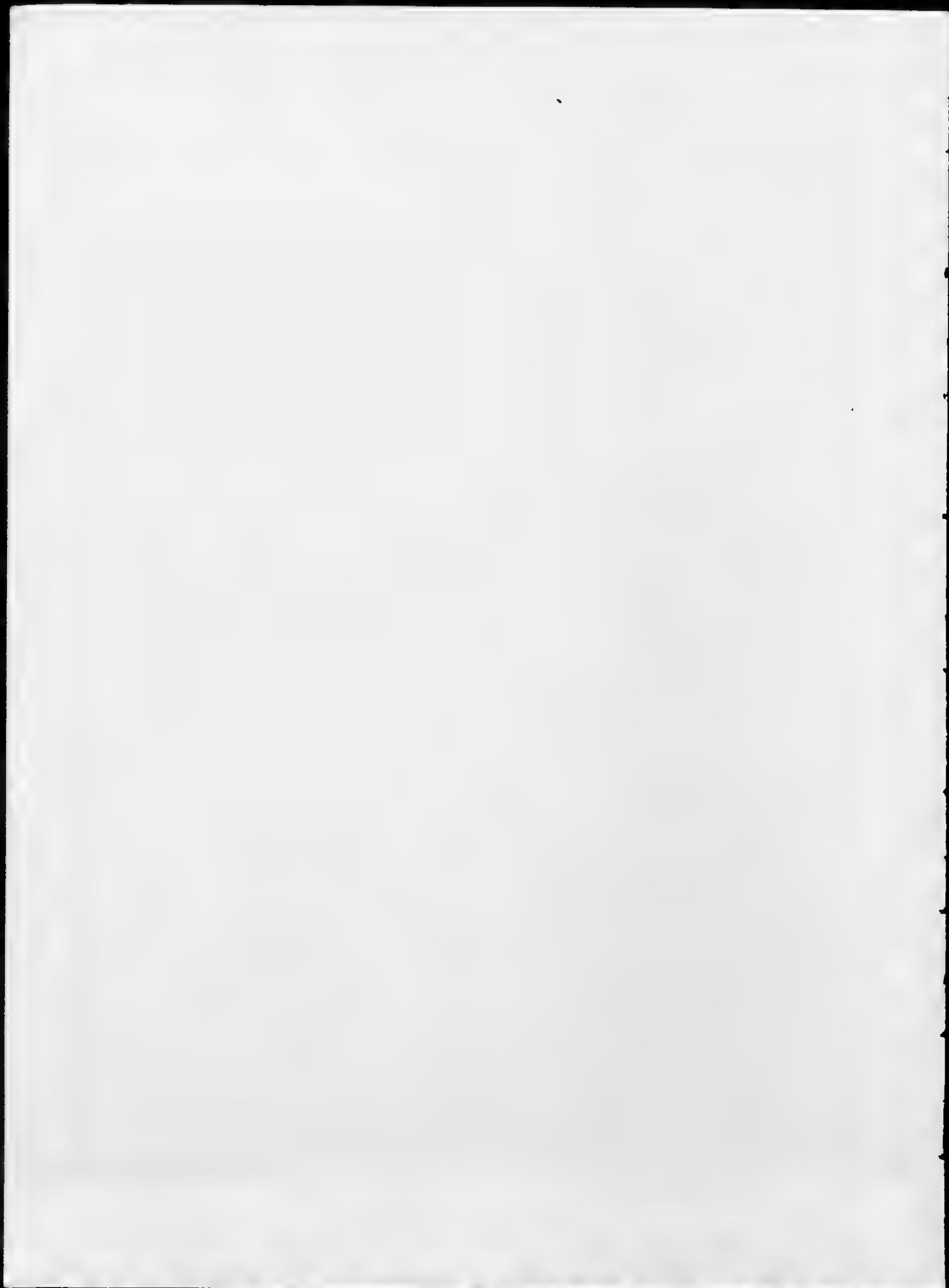
11. May the Commission punish those who insist upon an evidentiary hearing and other elements of due process by imposing the most severe sanctions within its power?

12. In imposing the ultimate sanction within its power, may the Commission (a) rely on a record seven to ten years stale; and/or (b) refuse timely application to update the record on the public interest issues; and (c) fail to make essential findings with respect to the "public interest" issue?



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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos.
71-1136
23,224
23,246

HAIGHT & CO., INC., ET AL.,

Petitioners,

-v-

SECURITIES AND EXCHANGE COMMISSION,

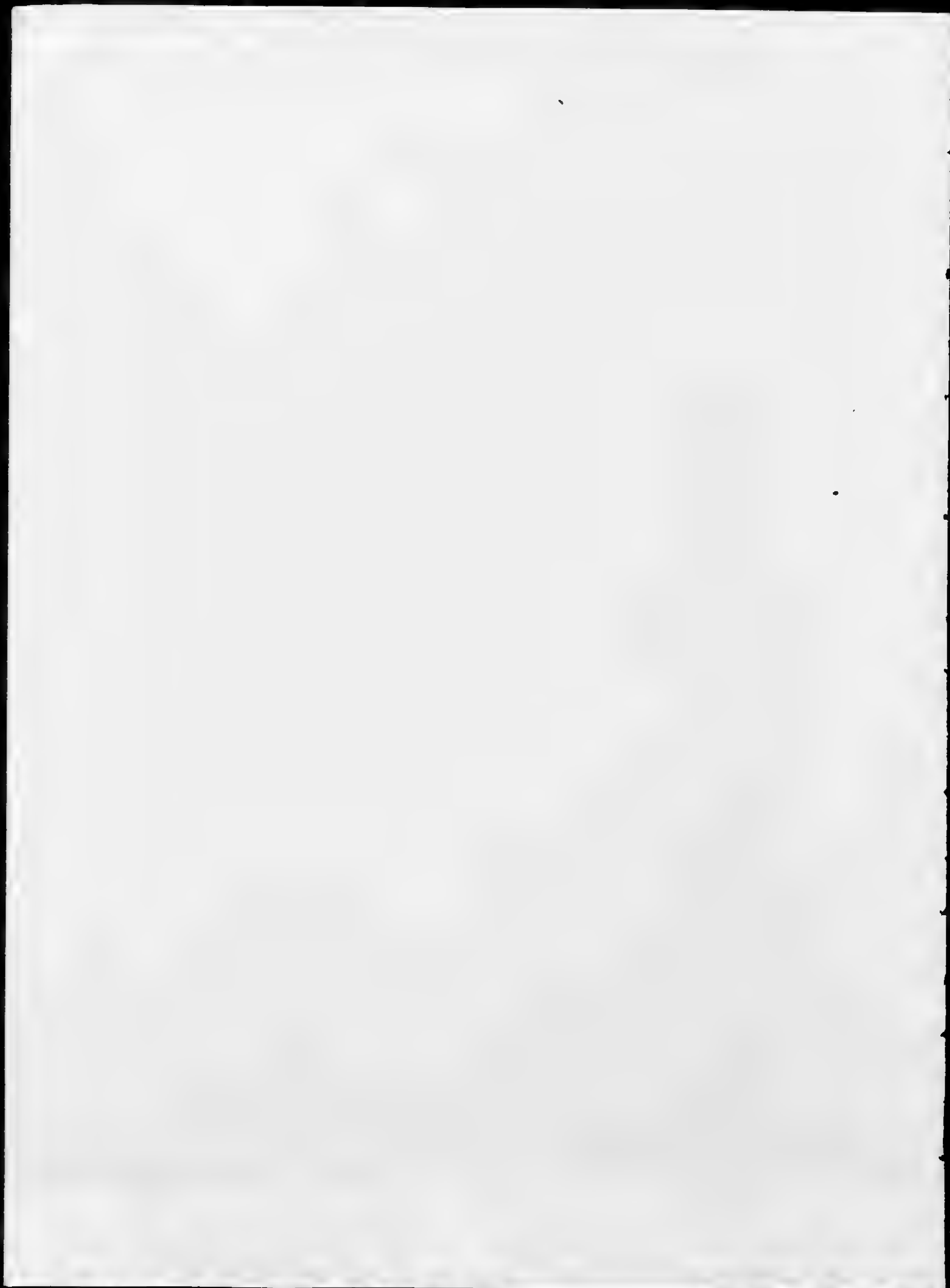
Respondent.

BRIEF FOR PETITIONERS

REFERENCES TO RULINGS*

The Initial Decision of the Hearing Examiner was rendered on May 15, 1969 and is set forth in the Joint Appendix at pages 118 to 279 . The Opinion of the Commission was rendered on February 19, 1971, and is set forth in the Joint Appendix at pages 305 to 339 .

*/ These cases have not previously been before the Court.



STATEMENT OF THE CASE

A. Nature and Jurisdiction

This case arises on a petition (Appeal No. 71-1136) filed pursuant to Section 25(a) of the Securities and Exchange Act of 1934, 15 U.S.C. §78y(a), to review and set aside an order of the Securities and Exchange Commission which revoked the broker-dealer registration of Haight & Co., Inc. (formerly Hodgdon & Co., Inc.)^{1/} and expelled it from the National Association of Securities Dealers and the Philadelphia-Baltimore-Washington Stock Exchange and imposed a lifetime bar from association with any broker-dealer upon petitioners Hodgdon, Haight, Carr, Kitain, Adam, Harper, Kibler and Davis.^{2/} It also arises upon a consolidated petition (Appeal No. 23,244) to review an order of the Commission denying a motion for leave to reopen the record to adduce additional evidence deemed relevant to the sanction issue and application (Appeal No. 23,246) for leave to adduce such additional evidence.

B. The Proceedings Before the Commission

On April 3, 1963, the Securities and Exchange Commission transmitted to the Congress Part 1 of the Report of the Special Study of Securities Markets (House Doc. No. 95, Pt. 1, 88th Cong., 1st Sess.). The Commission's preface pointed out that "the Report makes very clear that * * * grave abuses do occur" in the securities markets (id. at p. iii) and closed with a pledge that the Commission "will now turn [its]

^{1/} In conformity with the requirements of Rule 28(d), F.R.A.P., this petitioner will henceforth be referred to by name, as the "firm" or "registrant" or collectively with the individual petitioners as "respondents," the designation used in the proceedings before the Commission.

^{2/} These petitioners will henceforth be referred to by name or collectively as "individual respondents" or collectively with registrant as "respondents."

attention" to the problems disclosed by the Report (id. at p. ix).

Among the "problems" detailed by the Report was "a danger * * * that [a securities] specialist may not hold himself out to the public as such, but may project an image of equal willingness to sell, and equal knowledge about, securities other than those within his specialty." In such instances, said the Commission, "specialization strains the brokers' obligation to deal fairly with his customer, and strains it even further where a relationship of trust and confidence has been developed" (id. at p. 261). The Report went on:

"An example of this practice appeared in the study's public hearings. The brokerage firm of Hodgdon & Co., Inc., which employs over 50 salesmen in 3 offices, advertises itself extensively, both in newspaper and on the radio, as 'specialists in financial planning,' emphasizing in its advertisements its special ability to devise an investment program tailored to the individual needs of each customer. In fact the firm's salesmen are instructed, in making recommendations to customers who avail themselves of the firm's offer of financial planning, to follow a fairly rigid investment formula under which the customer will divide the major part of his capital between mutual funds and real estate syndications, the latter described by the firm as 'blue chips.' Approximately one-third of the real estate issues purchased by customers were in enterprises promoted by the firm, and one-half of the mutual fund shares sold were of a fund in which the proprietor of the firm had an interest through the fund's management company. Extra compensation is paid on sales of this fund and on real estate syndications promoted by the firm. The emphasis on real estate participations and mutual funds is reflected in the fact that in the firm's 8-year history, less than 20 issues of industrial companies have been recommended to customers and of these, 8 were underwritten by the firm" (id. at pp. 261-262).

Following transmission of the Report of the Special Study, the Commission continued its investigation into the affairs of Hodgdon & Co. Over two years later, on August 16, 1965, when it seemed apparent that the Commission was likely to institute a proceeding against the firm, a formal request was made that if such a proceeding be instituted, it

be conducted privately (JA 12). Notwithstanding that request, on March 2, 1966, the Commission issued an order for public proceedings which accused the firm, the individual respondents and other of offering and selling securities by means of untrue statements of material facts and omissions to state material facts and of engaging in transactions, acts, practices, and a course of business which operated as a fraud and deceit upon purchasers and prospective purchasers of securities. By way of specification, the respondents were said to have induced "inexperienced and unsophisticated customers to repose complete trust and confidence in them, causing such customers to believe that they would act in their best interest in connection with all purchases and sales of securities"; induced "customers, without regard to [their] financial needs and objectives, to sell seasoned securities out of their investment portfolios and reinvest the proceeds in unseasoned and speculative securities in which respondents had direct and indirect interest"; engaged "in the distribution and sale of speculative and unseasoned securities without first having made reasonable and diligent inquiry as to the true nature and worth of these securities"; sold three named securities when no registration statement had been filed with respect to such securities; failed "to reasonably supervise salesmen who were subject to their supervision, with a view to preventing violations"; and made untrue, deceptive and misleading statements with respect to six named securities. The period during which petitioners were alleged to have engaged in such conduct was designated as "from approximately May 1960 to June 1964" (JA 17). The issuance of the order for public proceedings was accompanied by a Commission press release which heralded the allegations of fraud.

On March 16, 1966, registrant and the individual respondents moved for an order dismissing the order for public proceedings on the

grounds that the Commission had prejudged the merits and that its refusal to conduct the proceedings privately and to hear oral argument on that issue constituted a violation of due process of law and Section 6(a) of the Administrative Procedure Act. The motion sought an order permitting them to examine and copy all communications pertaining to this matter between the staff and the Commission which referred to or related to the "Special Study" (JA 23). On April 18, 1966 the Hearing Examiner denied the motion on the grounds that the "'rule of necessity' conclusively rebuts" the contention that the Commission is precluded from acting by prejudgment (JA 30) and that even "assuming that the Commission had formed an opinion, it [docs] not necessarily mean that the minds of its members are irrevocably closed on the subject * * *" (JA 31). The request for production of communications between the Commission and its staff relating to the Special Study was denied on the ground that "since the motion to dismiss for prejudgment of the merits cannot be granted, such documents are neither relevant nor material" (JA 32-33).

A petition to review the Hearing Examiner's ruling (JA 34-35) was denied by the Commission on May 23, 1966 on the grounds, inter alia, that the order for public proceedings involved matters other than those discussed in the Special Study; and that the record in these proceedings would "as a matter of legal requirement, constitute the sole basis for its decision irrespective of any of the findings in the Special Study" (JA 49).

While their motion to dismiss was pending before the Hearing Examiner, the accused filed a motion for more definite statement, arguing that it was a denial of due process to require them to answer and defend against allegations as broad as having sometime during a period of fifty months induced or permitted others to induce unnamed customers

to sell unidentified "seasoned" investments and purchase unidentified "speculative" ones (JA 54-55). Respondents sought particulars with respect to the violations in which they were alleged to have engaged, including the names of such customers and the identification of such securities (JA 55-76).

This motion was granted in some respects and denied in others. Refused were the identity of the customers who had allegedly been defrauded. Granted was the request for specification of the allegedly speculative securities which were sold to these customers (JA 81). The Commission's staff, in apparent compliance with the Examiner's order, provided a list of 28 securities which were alleged to be "unseasoned and speculative" (JA 84-86). Thereafter they supplemented this list with 16 more allegedly "unseasoned and speculative" securities (JA 94-95).

Formal hearings on the charges commenced on June 14, 1966, rekindling the blaze of publicity that had accompanied the issuance of the order for public proceedings. As a consequence, a number of employees and many customers severed their relationship with the firm (JA 112-114). A renewed motion was filed to have the proceedings conducted privately (JA 100-101), and was successively denied by the Examiner and the Commission (JA 128-129).

The public hearings continued for a total of 108 days, finally concluding on July 27, 1967. The transcript was 13,530 pages. Over 1,100 exhibits were introduced, most of which were many pages in length. ^{3/}

Charged with the broad allegations that registrant's training program was technically inadequate, respondents devoted weeks of the

^{3/} No tabulation has ever been made of the total number of pages represented by these exhibits.

hearing to demonstrate the contrary. Charged with the distribution and sale of speculative and unseasoned securities, respondents offered extensive proof to demonstrate that few of the securities they sold were speculative and that the vast bulk represented fundamentally sound situations. Charged with engaging in the distribution and sale of securities without first having made reasonable and diligent inquiry as to their true nature and worth, respondents put on witness after witness to testify to the scope of their investigation of each such security. Charged with inducing customers, without regard to their financial needs and objectives, to sell seasoned securities out of their investment portfolios and reinvest the proceeds in "unseasoned and speculative securities in which respondents had direct and indirect interests," respondents introduced a vast amount of testimony to establish the reasons why customers were sometimes advised to sell securities which the Commission characterized as "seasoned" and reinvest the proceeds in other securities. Respondents also laboriously demonstrated that, with rare exception, they did not have any interest in such securities^{4/} other than their disclosed commission.

Charged with engaging in a "course of business" of defrauding customers in the guise of providing financial planning, respondents called as a witness the Commission's staff attorney who had been principally responsible for the investigation into the firm's affairs, for the stated purpose of proving that he had made an extensive examination of many of the firm's customer accounts, that the relatively few cases as to which evidence had been introduced were atypical, and that such

^{4/} In the exceptional cases, the direct and indirect interests of registrant or any of its officers had been fully disclosed by the prospectus. See, e.g., Westfalls Shopping Center Limited Partnership prospectus (Dx. 642, pp. 1, 3).

testimony would bear upon the argument that "certain general conclusions should be drawn from the evidence adduced" with respect to those relatively few customers (Tr. 13085-13086).

The Commission's staff objected to such inquiry on the twin grounds of executive privilege and attorney's work product (Tr. 13088-13089). The Examiner sustained the objection on the ground that the testimony to be adduced was not necessary since "this case * * * will be decided on the facts in this record and on nothing else" (Tr. 13091). The Examiner went on to say that "inferences to the extent that there are practices or other matters which may or may not be considered violative of the Securities' laws or practices above and beyond the extent produced by the record * * *" would not be drawn (Tr. 13091).

When counsel again voiced concern lest the Division nevertheless urge that inferences be drawn as to a "course of conduct" from the testimony of the few customer witnesses produced (Tr. 13092), the Examiner again stated:

"As far as I'm concerned, a ruling has to rely and has to be limited to what occurred here. And I don't think any inferences can be properly drawn that it did occur, because it occurred in this case or with respect to this customer or this client who was produced here as a witness and who testified it also occurred with respect to any client who did not testify here or with respect to whom no evidence was adduced" (Tr. 13093).

To this the Commission's staff voiced complete agreement (Tr. 13093).

A substantial part of the hearings was devoted to the effort to prove and disprove that misrepresentations had been made in the sale of real estate. The Commission contended that any representation suggesting a rate of return higher than taxable income was a fraudulent misrepresentation. From that proposition flowed the contention that the cash flow from real estate in excess of taxable income was merely

a Ponzi-like return of the investor's own money and hence would not satisfy any investor objective of maximizing income. Since the firm strongly advocated investments in income-producing, tax sheltered real estate, such investments accounted for a very substantial portion of the securities which were sold to their customers,^{5/} and this issue permeated the entire proceeding.

The Hearing Examiner's Initial Decision (hereinafter "ID") shows that his conviction that respondents had misrepresented the rate of return from real estate investments was a major factor in arriving at his recommendation that the firm should receive a four-month suspension from the NASD and PEW, that Hodgdon, Haight, Adam and Harper should be barred from association with a broker-dealer, that Kitain and Davis should be suspended for one year, that Carr should be suspended for ten months, and that Kibler should be suspended for five months (ID at 139-149, JA 269-279, et seq.).

After the Initial Decision issued, registrant and Haight moved to reopen the record to adduce additional evidence pertaining, inter alia, to matters occurring after the close of the hearing which were relevant to the sanction issue, but the Commission denied that motion (JA 305-307).

Respondents filed exceptions to most of the Examiner's underlying findings and to all of the proposed sanctions. The Commission's staff excepted only to the proposed sanctions against Carr and Kitain.

^{5/} "Between 1960 and 1964 registrant was the underwriter or a participant in a selling group of issues totaling about \$21,000,000. Of that amount real estate limited partnership syndications * * * and real estate stocks" totalled \$14,000,000 (ID at 16, JA 146).

The Commission granted review and sua sponte ordered that the review include every issue before the Examiner (JA 311-312).

Ultimately all of the Examiner's adverse findings with respect to real estate investments were rejected by the Commission, which said: "[W]e have not sustained the examiner's findings that fraudulent representations were made with respect to the rate of return on certain real estate securities offered and sold by respondents" (Op. at 28, n. 50, JA 337).^{6/}

The Commission also expressly or tacitly concluded that the Examiner had erred in finding or had not found (a) that the securities sold by respondents were unsuitable to their clients' needs (Op. at 15, JA 324); (b) that respondents' method of obtaining clients and information with respect to such clients was in violation of law (Op. at 15, JA 324); and (c) that individual respondents had violated the securities law by failing to properly supervise their subordinates.

Notwithstanding the rejection of a substantial part of the Examiner's findings of violation, the Commission imposed the maximum sanctions within its powers. It revoked the firm's broker-dealer registration and ordered it expelled from the NASD and PBW, and it imposed lifetime bars from the securities business upon every individual respondent (JA 338-339). The sanctions were based upon the Commission's conclusion that respondents had engaged in a "scheme to defraud" through the sale of "self-enriching" securities.

^{6/} The tacit finding that tax sheltered cash flow from real estate is not income is nonetheless the undergirding for the Commission's conclusion that when respondents sold investments in tax sheltered real estate they were not meeting their customers' stated objectives for more spendable income (Op. at 12-14, JA 321-323).

The order imposing these sanctions was issued on February 19, 1971, eleven months after oral argument, twenty months after the Hearing Examiner's Initial Decision, five years after the institution of formal proceedings, and nearly eight years after publication of the Report of the Special Study whose "findings" it echoed.

STATEMENT OF FACTS

The Commission's fact findings are in many respects not supported by substantial evidence. But of perhaps greater significance, the Commission simply ignored uncontradicted material evidence which was critical to the ultimate legal question of whether or not respondents' conduct was in violation of the securities laws. In respondents' view, the material evidence adduced at the hearing proved the following.

A. Registrant and the Individual Respondents

Registrant was in business for a total of fifteen years, from early 1956 when it was operated as a partnership until 1971 when it ceased doing business at the order of the Commission (Tr. 7362-7363). The firm was founded by Hodgdon, who was its president and controlling stockholder until July 1964 when the controlling interest was acquired by respondents Haight, Carr, Kitain, Adam and Harper, and Haight became president (Tr. 11924). Two respondents, Davis and Kibler, were never officers or stockholders of registrant. Until this proceeding was brought, the respondents had unblemished records.

In addition to the named respondents, from the time of its organization through 1966 the firm employed a total of about 170 registered representatives, and during the period relevant to the Commission's charges it maintained an average of about 10,000 customer accounts (Rx. 131, Tr. 11955, 12429).

The gross annual volume of its securities transactions over the period of 1960 to 1964 ranged from a low of \$11,300,000 to a high of \$17,450,000. Of this volume, approximately 25% was in listed securities, 25% in over-the-counter securities, 25% in mutual fund shares, 15% in real estate securities and 10% in industrial securities or oil and gas programs in which the firm acted as an underwriter or member of the selling group (Rx. 13K, 13L).

B. Financial Planning and Investment Preferences

The testimony established that Hodgdon had devised the concept of financial planning and the so-called "ratio system" because his experience and the experience of others had shown that most investors did poorly when they invested in individual securities in the conventional manner. This was so because of the predisposition of most persons to buy stocks on the basis of tips or rumors and the fact that most people become enthusiastic when securities prices rise and buy stock at the high and become frightened or despondent when prices have fallen and will sell at the low (Tr. 6220, 7360-7364, 7386, 7396). The firm taught that mutual funds were a superior investment vehicle for all average investors since (a) the selection of securities and the timing of purchases and sales would be left to professionals, (b) they were generally regarded as long-term investments, and (c) they provided a degree of diversification which would not otherwise be available and advised its salesmen to recommend that the average investor place at least 50% of his investable dollars in mutual funds (Tr. 6221-6222).

The firm maintained a preferred list of approximately 20 mutual funds, the sale of any of which would result in the payment of a small additional incentive commission (Tr. 2220, 7680, 12401; Dx. ^{7/} 147;

^{7/} The abbreviation "Dx." refers to exhibits introduced by the Commission's Division of Trading and Markets.

Rx.^{8/} 4X). The testimony showed that although salesmen were allowed to sell almost any fund, administration and record-keeping problems made it difficult to properly service purchases in the hundreds of funds that were available, and the incentive program was devised to encourage concentration and ease the back room burden (Tr. 2220, 7680, 12401; Dx. 147, Rx. 4X). The funds selected for the preferred list were generally the larger and outstanding funds in each category of investment policy (Tr. 7681).^{9/}

Hodgdon and the firm also strongly advocated investment in real estate, teaching that such investments would afford diversification away from a total investment in industrial stocks or bonds, would normally provide a higher rate of return than was available in industrial stocks and bonds and, in view of the provisions of tax law which favored ownership of real estate, would provide tax shelter for some or all of these returns (Tr. 7421-7422, 6303, 9904-9907, 8045).

In selecting real estate securities which would be underwritten or sold by the firm, certain essential qualifications were always sought in order to limit such offerings to what the firm believed to be "high quality" real property. Among these criteria was the willingness of a

^{8/} The abbreviation "Rx." refers to exhibits which are introduced by the respondents.

^{9/} The Aberdeen Fund, in whose management company Hodgdon was a stockholder, was one of these 20 preferred funds, but that this was not the reason for its selection was demonstrated by proof (a) that after Hodgdon sold these shares, Aberdeen nonetheless remained on the preferred list and was sold in even greater quantities than prior thereto, and (b) that Hodgdon had large personal holdings in the management companies of two other funds, neither of which were on the preferred list (Tr. 639, 7681, 7683, 7684). The Commission's opinion (at p. 5, JA 314) also infers that the 20 funds were selected on the basis of their willingness to give "registrant reciprocal business." At the time, however, as the Commission's own investigations have revealed, reciprocal business was given by all funds and hence this could not have been a basis for selection of particular funds.

major institutional lender to make a sizeable conventional loan on the property; substantial size; new and modern construction; and location, with the Metropolitan Washington Area being favored because it was relatively immunized from the business cycles which had some impact on real estate elsewhere (Tr. 7425-7426).

Although opportunities for syndication of two to three real properties were offered to the firm during its entire history, it chose only eleven limited partnership syndications as appropriate for public offering (Tr. 7514).^{10/} In addition, the firm participated as one of the underwriters in the initial offering of other real estate investments such as First National Real Estate Investment Trust, Western Mortgage Investment Trust and Apache Realty Corporation (Rx. 13K).

The firm taught that if persons were going to speculate, they should put a predetermined maximum on that portion of their investable dollars which would go into speculations (Tr. 6222, 7796). The firm also advocated that in choosing speculations, preference should be given to local companies with which the investor could identify and as to which information would be readily available (Tr. 6220, 7437, 7591, 7789, 7790). Included among the small local companies which were underwritten by the firm were Scope, Dart Drug and Kent Washington.

The firm also believed and taught that the purpose of life insurance was to protect against the risk of death and that straight life, twenty-payment life and other similar policies, with their low interest rate assumptions and lack of protection against the erosion in the value

^{10/} These included the Federal Bar Building, the Penn-Daw Shopping Center, Rock Creek Forest Apartments, Falls Plaza Apartments, West Falls Shopping Center, Cheverly Terrace Apartments, Holiday Inn of Richmond, and the Gem Department Store in Detroit (Rx. 14J).

of the dollar, were poor vehicles for savings and investments (Tr. 8707-8709).

The respondents' sincere belief in the value and desirability of the securities which they were selling is evidenced by their purchase of these securities for their own accounts. For example, Hodgdon or his wife purchased Penn-Daw, Federal Bar Building, Toledo Plaza, Capital Properties, Richmond Motor Lodge, Big Fish Little Fish, The Connection, Lord of the Flies, Jonker Business Machines, Scope, Orbit, Kent Washington, Watson, Major Finance, Van Pak and Apache Oil and Gas Programs, all of which the firm underwrote or participated in as a member of the selling group (Rx. 8T). The same was true with respect to other individual respondents. (See, infra, pp. 23, 26, 30, 34).

C. Sales Commission Structure and Compensation

The gist of the Commission's opinion is the conclusion that "financial planning" was a mere facade for "self-enrichment" through sales concentration on high commission securities.

Mutual funds and new issues underwritten by the firm, including real estate securities, did carry much higher commissions than a security listed on a national exchange. A mutual fund sale carried an average commission of about 7% and new issue underwritings 8% to 10%, whereas the commission on a listed security averaged about 1.5% (Rx. 13L and, e.g., Dx. 629, 642). However, mutual funds and real estate securities were sold as permanent or long-term investments and the firm's client accounts showed very little turnover. Thus, whereby conventional brokerage activities in listed securities would produce periodic turnover of customers' investments, with resulting commissions on both the purchase and sale, the sales commissions on investments by the firm's financial

planning clients were a one-time fee (Tr. 7186, 12506-12510).

In addition, the advocacy of financial planning concepts and the implementing sales of mutual funds occurred only at face-to-face interviews which were much more time-consuming than a telephoned recommendation for the purchase of a single security concerning which some "hot" news had developed. The record showed that ten calls produced an average of two interview appointments and, of course, not all interviews resulted in sales (Tr. 3739-3740, 9894).^{11/}

Moreover, the amount of commissions that were payable on the purchase of mutual funds and underwritings were clearly set forth in the prospectuses (see, e.g., Dx. 629, 642; Rx. 4A), and Carr, whose instructions to salesmen are the subject of substantial criticism in the Commission opinion, taught salesmen that they should specifically call the customer's attention to the sales charge on mutual funds by circling the amount of the commission in the prospectus (Tr. 9914-9915).

D. Advertising and Sales Training

The firm advertised extensively on radio station WGMS,^{12/} and the Commission's staff put the text of 63 radio commercials into evidence (Dx. 554-617). Examination of these 63 commercials shows that those which the Commission's opinion declares to be "representative" were anything but representative (Op. at 3, JA 312). In fact, the first so-called "representative advertisement" which the opinion quotes for its

^{11/} The firm prohibited the sale of securities by telephone to persons who were not already established clients (Tr. 10731). Such sales are the hallmark of a "boiler shop" operation.

^{12/} Despite this extensive advertising, only one witness, a Mr. B., contacted the firm in response to its radio advertising (Tr. 1823).

promise of "long range gain, immediate gain" was not an advertisement at all. The copy was plainly marked at the top "DON'T USE" (Dx. 555), and another copy of the same commercial (Dx. 557) showed that these words had been stricken.

The radio commercial quoted by the Commission to support the conclusion that the firm misled people into believing that registrant would put their funds into "long established stocks [and] bonds," was hardly "representative,"^{13/} since it was the only one of some 60 commercials that contained such language. The only theme that can truly be said to be "representative" of this advertising was the recurrent reference to "financial planning" (see, e.g., Dx. 554, 556, 558, 560, 562, 564, 566, 568, 578, 582, 598, 603, 606, 617).^{14/}

The firm's advertising does make frequent reference to its team of specialists, each of whom were proven to have studied and read extensively within their fields of specialization. These specialists were used both as lecturers and as resource persons within the firm. They were not lawyers or engineers, but there was no evidence that any of them had given erroneous information to anyone. During the hearing, the firm's specialist in trusts, estates and taxation gave a somewhat condensed version of the six lectures which he gave to the firm's registered representatives as part of their advanced training course (Tr. 9441-9551; Rx. 9U-10U), and there is no suggestion that any of the things he taught were wrong. Similarly, the firm's insurance specialist gave a rendition of his four-lecture course on many technical aspects of insurance and was not shown to be in error in any respect (Tr. 8636-8708, Rx. 9J). The

^{13/} In fact, however, the firm did deal in long established stocks and bonds. The uncontroverted evidence shows that approximately 25% of its volume was in listed securities (Rx. 13L).

^{14/} This was also the theme of registrant's brochures (Rx. 8U-W).

firm's gas and oil specialist received both field and course training from the Apache Corporation and held a master's degree from the Massachusetts Institute of Technology (Tr. 6237, 6576, 9909-9911; Dx. 620). The firm's specialists in military retirement and survivor's benefits were retired Army and Navy officers (Tr. 2086-2097, 2102-2103).

The firm's salesmen were given instructions in salesmanship and were taught that it was difficult to lead people away from their tendency to spend money for immediate gratification or "play the market" (Tr. 7390, 7386, 7417). Thus, they were taught a variety of sales techniques, all of which were designed to motivate and induce a prospect to purchase those investments which were believed to be suitable and appropriate. For example, representatives were told to discuss what might be achieved through a regular, disciplined investment program in creating financial independence, a prosperous retirement, etc. These appeals were referred to during training sessions by the verbal shorthand "appeals to greed," which appellation is seized upon in the Commission's opinion (Op. at 6, JA 315). Salesmen were also told to discuss how many oldsters are required to live on the charity of friends and relations and how inflation has whittled away at the value of the dollar. In training, these were referred to as "appeals to fear." And in speaking of a goal or objective which would motivate a particular individual to action, the firm's instructors referred to this as the customer's "hot button" (Tr. 3869-3871, 10089, 11854-11856, 11859-11861). Admittedly, sales techniques were taught which would move the prospective client to take action, but this is not to say that such techniques were used to commit fraud or that the particularizations of those techniques at pages 5-7 of the Commission's opinion are supported by the record.^{15/}

^{15/} The Commission found that Carr gave instructions that if a customer decides to cancel a purchase after reading the prospectus, he should be told, "What, cancel! You should have doubled your order" (Op. at 6,

(cont'd)

The Commission did not find that these techniques were employed to sell the customer securities which in the firm's or the salesmen's view were unsuitable to the customers' needs and objectives.

The "sales policy" memorandum referred to at page 5 of the Commission's opinion, which made mandatory minimum sales of mutual funds or other "high quality" securities, defined "high quality" as being other than "low priced speculative securities" (Rx. 13X), and, as the Commission's opinion points out, failure to comply "was ground for and did occasion dismissal" (Op. at 5, JA 314). The salesmen who were discharged for violation of this policy memorandum were those who emphasized speculative securities. Two of these discharged salesmen were producing \$48,000 a year in net commission income to the firm (Tr. 85, 9864-9865, 11892, 12457-12459, 12265, 12293-12461), which was far more than the \$7,200 a year earnings from sales of funds and "high quality" securities which the policy memorandum set as a minimum goal.

During the relevant period, registrant maintained an average of 10,000 customer accounts. The Commission's opinion deals with only 19

15/ (cont'd)

JA 315). The context in which such a statement was made showed that it was not intended as a general instruction (Tr. 9935-9936), and one of the Commission's witnesses, a customer of Carr's, testified that when he expressed dissatisfaction with a new issue upon reading the prospectus, Carr specifically advised him that he had the option of canceling the order if he wished (Tr. 1448). The opinion also attributes to registrant's insurance specialist a statement that the firm's "only purpose in discussing insurance [was] to free more monies" for purchases of securities (Op. at 6, JA 315). This statement was a jotting made by a Commission witness while attending a lecture by the insurance specialist. The witness, however, steadfastly declined to recall that this statement was made by the specialist although his notes were put before him. Since the firm's insurance specialist received virtually all of his income from commissions on insurance sales, it is most unlikely that he would have said that the firm's "only purpose in discussing insurance [was] to free more monies" for purchases of securities. Rather, it undoubtedly represents the Commission's witness' paraphrase of the teaching that as a registered representative who did not hold an insurance license, he could not earn any money from policy conversions.

cases which we will discuss seriatim.

E. The Individual Respondents and Their Client Cases

David M. Adam, Jr.

During the period covered by the Commission's charges, Adam was handling an average of over 200 accounts (Tr. 8127-8130). The Commission's conclusion that Adam and the other respondents used financial planning as a guise for a scheme to defraud rests on two of Adam's cases.

The Commission found that Adam had "caused Dr. G. to sell her entire portfolio of listed securities and cash in her annuity" and to use the proceeds to purchase \$30,000 in mutual funds, a "highly speculative" \$12,500 oil and gas program, and \$50,000 in other securities (Op. at 7, JA 316).

When Adam met Dr. G. she was 35 years old, single, and a self-employed anesthesiologist with an income of \$21,000 per year which she expected would soon grow to \$30,000 to \$35,000 a year (Rx. 9C, Tr. 8144, 8147). Aside from cash and a home, she had a \$40,000 fully paid annuity, 350 shares of American Smelting and Refining common stock, 30 shares of its preferred, and 60 shares of American Telephone and Telegraph (Rx. 9C).^{16/} Her investment objective was to accumulate capital for ultimate retirement (Tr. 8834-8836).

Analysis of her annuity showed that it was based on an interest accumulation at a rate of only 2-1/2% per annum (Tr. 8746-8748), and

^{16/} The Commission's characterization of holdings in the securities of two companies as a "securities portfolio" is substantially out of keeping with the meaning of the term "portfolio" as it would be used both in the investment industry and in general usage. If the word "portfolio" implies diversification, it cannot be used to describe holdings in a total of two companies.

recommendation was made that it be liquidated and the proceeds invested in something with a better rate of return. With regard to her securities, investment research services indicated that American Smelting's earning power had been declining and that it was in a very cyclical industry with wide fluctuations between profits and losses (Tr. 8151-8152). Adam discussed the desirability of retention of this investment with Dr. G.'s father, who was formerly a vice-president of American Smelting, and he supported the view that the stock ought to be sold (Tr. 8151-8152). A portion of American Smelting was sold in one year, the balance the next. Sometime later, after several investment advisory services and the analyst of one leading mutual fund concluded that American Telephone and Telegraph shares were overpriced, Adam recommended that Dr. G.'s shares be sold. The stock was then quoted at \$130,^{17/} which was near its all-time high (Tr. 8169-8172, Rx. 14Q).

The cash value of Dr. G.'s annuity and the proceeds from the sale of these securities were reinvested; \$30,000 went into mutual funds, \$50,000 went into other securities, including \$20,000 in real estate investments, and \$12,500 was invested in two annual oil and gas programs sponsored by the Apache Corporation (Op. at 7, JA 316). These oil and gas programs offered special tax features for investors whose income placed them in a bracket of over 50%, and during the years in question Dr. G.'s income put her in the over-60% bracket (IRC Section 1). Adam explained the Apache Oil and Gas Program to both Dr. G. and her accountant, and Dr. G. expressed her view that she "can afford something like this" and that "the tax savings will be a big help" (Tr. 8491-8492, Dx. 83a). The speculative aspects of these programs were explained in the prospectuses, copies of which Dr. G. received incident to purchase (Tr. 58) So was the amount of commission which would be payable to Adam and the firm

^{17/} This was equivalent to a post-stock split level of \$65.00.

Captain S. first consulted Adam while still a client of another brokerage firm as to whether he should switch to one mutual fund from another (Tr. 8235). Adam consulted with Haight and Carr, both of whom advised against the switch. Their opinions were passed on to Captain S., who made the switch nonetheless through his account at the other firm (Tr. 8325-8326).

In the summer of 1960 Adam recommended that Captain S. invest \$5,000 in a limited partnership formed to purchase a new apartment project in Silver Spring, Maryland (Tr. 8237-8238). Captain S. rejected the proposed investment, stating that he was more interested in getting a 50% return on his money in the stock market (Tr. 8238). Later that year, Captain S. furnished Adam with a list of his securities holdings, expressed personal dissatisfaction with some of these stocks, told Adam that he was interested in capital gains, not in income, and asked for Adam's recommendation (Tr. 2649, Dx. 199).

Adam checked these securities in Standard and Poor's, the Value Line Reports, and Moody's, read their annual statements, spoke to representatives at other firms about them, consulted with Hodgdon, and discussed oil and gas securities with a mutual fund's oil stock analyst (Tr. 8241-8250). Following this extensive investigation, Adam recommended that approximately half of Captain S.'s stocks be sold as unsuitable to his stated objective of capital gains (Tr. 8251-8252, Dx. 208). Adam further recommended that the proceeds from the sale of these securities be invested in shares of Brunswick Corporation, H. W. Lay Company (now Frito-Lay), and Beauty Counsellors, none of which were underwritten by the firm. Captain S. accepted all three recommendations after he read the Standard and Poor reports for these three companies (Tr. 8253-8254).

Adam subsequently recommended purchases totaling approximately

\$6,000 in five speculative securities underwritten by the firm, all of which he labeled as such in his discussion with Captain S. In most instances, Captain S. purchased or attempted to purchase more shares of these speculations than Adam recommended he buy (Tr. 2678, 2768, 2773a, 2779-2780, 8270-8273, 8299-8300, 8517, 8522). Captain S.'s penchant for speculative securities was not limited to those recommended by Adam. In early 1962 he purchased \$2,000 of a low-priced speculative security from another stockbroker with whom he happened to play golf (Tr. 2696, 8304). He also fed Adam "hot tips" which he received from another Naval officer (Tr. 8305). Captain S. also rejected Adam's recommendations for purchases of IBM, Pepsi-Cola, and other listed securities (Tr. 2722, 8292).

Over the course of some four years, Adam continued to watch the performance of other securities owned by Captain S. In keeping with Captain S.'s stated objective of capital gains, when Adam concluded that a stock was fully priced, he would recommend that it be sold.

If one were to assess these sales recommendations on the basis of the performance of the securities after the recommendation for sale, it would appear that Adam's analyses were extremely sound. Four out of five of the securities sold were lower in price three months after their dates of sale, at year-end 1963, and at year-end 1964 (Rx. 14U, Tr. 8273-8294, 8301-8303).

Captain S. first purchased real estate limited partnership units from Adam in early 1961, after studying the prospectus for two weeks. The purchase was made with the proceeds from two insurance policies which Captain S. cashed in at his own volition after telling Adam that he had noted that the cash value of these policies was almost equal to their face amount and that they provided no insurance benefit (Tr. 2797, 8289,

Dx. 530). Captain S.'s next purchase of a real estate investment was made in part with funds that Captain S. borrowed from a bank (Tr. 8307).

The Commission found that Adam recommended that Captain S. purchase shares of a speculative security on the same day that he recommended that Dr. G. sell her shares of the same company (Op. at 8, n. 14, JA 317). The evidence showed that in November 1961, Adam recommended to both Captain S. and Dr. G. that they sell their shares in this company and take the tax loss which would thereby be sustained (Tr. 8580). Dr. G. accepted this advice, but Captain S. expressed reluctance to take a loss if there was any hope of the stock's coming back. Adam confirmed that while the stock had substantially declined in value, there was a chance of its coming back^{18/} and suggested that Captain S. could retain his position and obtain the tax loss deduction by purchasing shares in November and 31 days later, before year-end, selling an equivalent number of shares which he owned at a much higher cost basis (Tr. 2735, 8580-8582). Captain S. did precisely that. The shares which Dr. G. was selling were "crossed" in the firm's back office, thereby reducing the firm's commissions on both transactions. Thirty-one days later, Captain S. sold his higher-priced shares (Tr. 8582, Dx. 530).

The record establishes that Adam purchased for his own account, for his parents' account, and for his mother-in-law's account the same mutual funds and other securities, the purchase of which by his customers was deemed to be evidence of fraud (Tr. 8121, 8331-8336).

^{18/} Adam based this judgment on market letters received from a broker located in the same area as the company in which the investment had been made, stating that the price of this company's shares could very well return to former levels (Rx. 9G, 9H, Tr. 8576-8579).

James W. Harper, III

The Commission's opinion discusses three of Harper's customers.

Mrs. D., whose \$200,000 in securities yielded her an income of \$7,500, told Harper that she needed to increase the yield from her portfolio (Tr. 2413-2414, Dx. 156). Harper thereupon examined her portfolio and obtained information concerning her holdings. Harper recommended the sale of a number of her securities which were then yielding as little as 1.9% of their market value (Tr. 2414, 6899-6900). He also recommended that Mrs. D. sell her 200 shares of R. J. Reynolds Co., then worth approximately \$30,000, basing his recommendation on the fact that the Royal College of Surgeons in London had just published a report on cigarette smoking which Adam thought might have adverse implications for the future of tobacco stocks (Tr. 2411, 6901, Dx. 430); on the fact that Mrs. D. had some \$40,000 in Reynolds, a dangerously disproportionate position in a single security; and on the fact that Mrs. D. expected to inherit still another block of Reynolds from her 82 year old mother (Tr. 2408-2409, Dx. 155). Those securities which Harper believed were paying satisfactory yields ~~or~~ which had good growth potential, were recommended for retention (Tr. 6898, Dx. 155):

Mrs. D. followed Harper's recommendations except that after discussion with her accountant, she determined to sell only half of the Reynolds tobacco stock in one year, thereby limiting the capital gains tax which she and her accountant knew would be incurred on these sales transactions (Tr. 6902).^{19/}

^{19/} Mrs. D. purchased an oil and gas program which Harper recommended for the purpose of reducing the taxes which would otherwise be incurred by the sale of other securities. Harper advised Mrs. D. of the purpose of such recommendation and that the program had to be regarded as speculative (Tr. 2321, Dx. 462, Rx. 2T).

In September 1962, after Mrs. D. expressed concern over the changes made in her portfolio, Harper made a special analysis comparing the prices at which securities had been sold against their then-market price. That analysis showed that 14 out of 16 securities sold had declined in value since the dates of sale and that if those securities had been held, their total value would have diminished by almost 25%
^{20/}
(Dx. 174).

The Commission's opinion finds that during a three-year period Mrs. D. sold more than \$122,000 in securities from her original portfolio. It omits the fact that at the end of the period, Mrs. D. still retained approximately \$100,000 of that portfolio, consisting of individual securities which were found suitable for retention (Rx. 14R).

In addition, of the \$69,000 in new issues which registrant was underwriting or acting as a member of the selling group, the sale of which to Mrs. D. the Commission regards as evidence of fraud (Op. at 9, JA 318), \$68,000 was in real estate securities which Harper believed would satisfy Mrs. D.'s stated objective of increasing her income, whereas the securities which she sold had not comported with this objective (Dx. 429).

The second Harper customer, Mrs. M., told Harper that she was interested in both high-yield and growth and that her primary interest was in income-producing real estate which would provide her with retirement funds (Tr. 1861, 6933-6934). She was referred to Harper by a real estate broker to whom she had gone seeking real estate investments (Tr. 1926-1928). Of Mrs. M.'s total purchases through Harper of \$27,700, \$21,000 were in real estate securities, and, as the Commission's opinion

^{20/} The 100 shares of R. J. Reynolds which had been sold for \$22,414 would have declined in value to \$12,255.

points out (Op. at 9, JA 318), \$2,500 was in mutual funds.

The third Harper customer referred to by the Commission, Dr. B., was a dentist who in late 1960 told Harper that he had \$5,000 with which he would like to speculate (Tr. 5024, 6864, 6869). In the next seven months, Dr. B. realized gains of \$4,500 from speculative situations (Dx. 507A-B). At Harper's urging, Dr. B. then began to invest his monies in mutual funds and real estate securities which were being offered by the firm (Tr. 6871, Dx. 507A-B). The real estate securities sold to Dr. B. all represented prime real estate in the Washington area, and Harper's characterization of these investments as "high grade" was ^{21/} well supported.

Burton Kitain

Kitain and members of his immediate family made substantial investments in mutual funds and securities underwritten by the firm (Tr. 10805-10807, 10926, Rx. 12E). The Commission's conclusion that he participated in the scheme to defraud is predicated upon his handling of three accounts..

The first of these is the case of Mrs. Y. who complained to Kitain that her relatives, who had been entrusted with management of her \$100,000 in investments, had not been paying enough attention to her interests. She said that she was personally "ill informed" on investments and that since she and her husband were frequently overseas on State Department assignments, she would like to free herself from concern over

^{21/} The Commission criticizes this characterization (Op. at 9, JA 318) without citing any facts or making any findings to show that the characterization of the real estate was erroneous. Similarly, the gas and oil program which Harper characterized as "high grade" had been well seasoned, all exploratory work had been completed, production had commenced, and the geologist had fixed the total reserve. At that stage, an oil and gas program is as high grade a security as Standard Oil of New Jersey.

both the selection of investments and the collection and reinvestment of dividends (Tr. 2494, 2548, 11086-11087). Kitain told her that the ideal vehicle to achieve these objectives would be mutual funds with arrangement for automatic reinvestment of dividends (Tr. 2494, 11099-11100).^{22/} Kitain expressed the view that, given her age and the age of her husband, her then-portfolio contained an excessive amount of fixed dollar and non-growth situations (Tr. 11101).

At Mrs. Y.'s request, Kitain prepared specific recommendations for the sale or retention of securities in her portfolio. He examined Standard and Poor's, Value Line, the Babson Letters and other sources of information. He then recommended approximately \$30,000 in securities as candidates for immediate sale. He also recommended retention of such securities as General Electric, Standard Oil of Indiana, Northern Illinois Gas Company, and Pacific Lighting (Tr. 11108-11111, 11119-11120, Dx. 197).

The entire market declined sharply in May and June of 1962 and so did the value of Mrs. Y.'s mutual funds. Mrs. Y. thereupon berated Kitain and changed brokers, and sold out all of her funds (Tr. 2515-2516, 2529, 2581, 2584, 11132-11134). At the time she ceased being Kitain's client, approximately \$60,000 of her holdings, or 60%, were in individual securities retained from her original holdings (Rx. 14V).

The Commission's opinion states that Mrs. Y. was not told of the capital gains taxes which these transactions might entail (Op. at 10, JA 319). But Mrs. Y. testified that when Kitain discussed the capital gains taxes that would be incurred if she acted on his sale recommendations

^{22/} Mrs. Y. admitted that the amount of sales commissions that would be payable on the purchase of the mutual funds had been discussed with her prior to her making the investments (Tr. 2496, 2503-2506) and, of course, the funds prospectuses, copies of which she had prior to making the investment, made all of the Commission rate disclosures that the Commission's Division of Corporate Finance thought to be appropriate.

she expressed the belief that her gains would be offset by large deductions arising out of the operation of real property which she owned in Vermont (Tr. 2501-2561). Mrs. Y.'s accountant did offset these expenses against securities profits with the result that there was no capital gains tax. It was only on audit by the Internal Revenue Service that the expenses were disallowed, with a resulting tax assessment of approximately \$4,000 (Tr. 2499, 2566-2567). Kitain had never seen the property, did not know what expenses were being incurred in connection with its development and management, and had no basis for disbelieving Mrs. Y.'s statement that she would have large tax deductions (Tr. 2501, 2565). The notion that Kitain could be barred because Mrs. Y. was assessed for these taxes (Op. at 10, JA 319) demonstrates how far the Commission is prepared to go to punish these respondents.

Mrs. R., the second customer referred to by the Commission, was an intimate personal friend of Kitain and his family. Mr. R. held odd lots in three listed securities, and Kitain recommended that two of these were good growth stocks and should be retained. The other, he said, should be sold (Tr. 267, 10951-10952). Kitain advised, however, that if Mr. R. were interested in continuing management and the benefits of diversification, considering the relatively small size of his holdings, this could be best achieved through the vehicle of mutual funds (Tr. 10953).

The firm's insurance specialist also advised Mr. R. that, considering his age and family circumstances, he should change his \$22,000 in twenty-payment life insurance into \$40,000 in term insurance, with a reduction of 50% in premium, and invest the premium savings in mutual funds (Tr. 10978-10979).

Some of these recommendations were accepted, others were rejected, and still others were accepted only in part. Instead of increasing the

amount of his insurance coverage and changing the type of insurance, Mr. R. borrowed the cash values from his policies and with the proceeds purchased some mutual fund shares, some shares of a listed company, and small amounts of two speculative issues recommended by Kitain (Tr. 10980, 11424, 11588, Dx. 23 and 742), for, as the Commission's opinion states, Mr. R. was interested in speculations (Op. at 10, JA 319).

The last Kitain customer discussed in the Commission's opinion, Mrs. A., was Mr. R.'s mother-in-law. She had \$50,000 in a savings and loan account, \$10,000 in Government bonds, \$30,000 in securities, and \$90,000 in a trust fund which she complained was being managed too conservatively from an income-production point of view (Tr. 783-785, 11028, 11035, 11603, Rx. 14-0). Since so much of her assets were in fixed dollar situations and Mrs. A. described her objectives as a certain amount of income and maximum growth, Kitain recommended that a portion of the funds in her savings and loan account be invested in mutual funds. Mrs. A. followed the recommendation to the extent of \$15,000 (Tr. 11450, 11038-11041). When Mrs. A. stated that her withdrawal from her savings account would deprive her of \$600 a year of interest, Kitain pointed out that mutual funds usually declare income and capital gains dividends, and that while he would recommend that these dividends be reinvested and allowed to accrue, Mrs. A. could, if she desired to do so, withdraw \$600 a year from her mutual fund account. Mrs. A. started such withdrawals and then discontinued them. She subsequently sold these shares at her own volition. Had she not done so, she could have continued to withdraw at the rate of \$600 a year and the value of her retained shares would have substantially increased in value nonetheless (Tr. 792, 808, 813, 11042, 11038-11041, 11458, 11461-11462, Rx. 14H).

Of Mrs. A.'s original \$30,000 in securities, \$21,000 were still held by her when she ceased doing business with Kitain (Rx. 14-0). Of

the \$28,500 in securities purchased by Mrs. A. which were underwritten by the firm or as to which it was a selling group member or acted as principal, over \$25,000 represented purchases of real estate securities designed to meet Mrs. A.'s expressed objective of increasing her income (Dx. 524).

Homer E. Davis

Davis and his mother made substantial purchases of securities underwritten by the firm (Rx. 11U). The Commission's opinion discusses two of his more than 300 accounts (Tr. 10343).

Mr. and Mrs. M. had no children. Both were employed and earned a joint income of \$15,500 per year (Rx. W). They told Davis that their goal was financial independence in the future and that they did not need any money at that time (Tr. 1500). They purchased \$22,500 in securities at Davis' recommendation, of which some \$7,500 was in mutual funds and most of the balance was in securities underwritten by the firm (Dx. 538), almost all of which were the same securities which Davis had purchased for his own or his mother's account.

The second customer referred to by the Commission, Commander C., was recommended to Davis by another customer who dealt almost exclusively in speculative securities. Commander C. had a total of \$1,000 in securities when he wrote to Davis requesting the opening of a discretionary account (Tr. 542). When Davis recommended that Commander C. put his money in mutual funds, the Commander rejected the suggestion (Tr. 592-595, 10379, 10578). Instead, he advised Davis that he would like to be speculative (Dx. 41). Davis acceded to his request and made a number of speculative purchases for his account. Some of these went up and others went down (Dx. 488, 489). Here, too, the securities which Davis was purchasing for Commander C. were largely the same ones which he was

purchasing for his own account.

Robert F. Kibler

The Commission's opinion (at p. 12, JA 321) deals with two of Kibler's approximately 250 clients (Tr. 9041-9042). The first of these, Mrs. S., a 70 year old widow, stated that her objectives were safety of principal and maximum spendable dollars (Tr. 4434, 4436, 9023). Kibler examined her \$50,000 portfolio and recommended retention of Continental Illinois Bank, Corn Products, Electric Storage Battery, Potomac Electric Company, Southern New England Telephone, and Warner-Lambert, since these holdings were producing adequate income and their earnings and dividends were increasing steadily (Tr. 9008-9018). He recommended liquidation of her railroad stocks, Acme Steel, Kennecott Copper, and Paramount Pictures, since these did not comport with Mrs. S.'s objectives (Tr. 9017). In each instance, he explained to Mrs. S. the reason for these recommendations (Tr. 9003-9017).

Mrs. S. followed Kibler's recommendations and invested \$12,500 of the proceeds in shares of Investment Company of America, a leading mutual fund, and approximately \$19,000 in real estate securities which registrant was underwriting, the tax sheltered cash flow from which Kibler believed would achieve Mrs. S.'s stated objective of "more spendable dollars" (Dx. 496, Tr. 9021, 9162-9163, 9177, 4454, 4452-4453).

In addition to the tax sheltered income which Mrs. S. received from her real estate investments, she increased her spendable dollars by reinvesting her income and capital gains dividends from her mutual fund and making withdrawals from her mutual fund account at a rate equivalent to 8% of her original investment (Tr. 9180). Mrs. S. was told and understood that such withdrawals could reduce her capital if the fund did not produce income dividends, capital gain dividends, and realize

value appreciation which equalled or exceeded the 8% figure (Tr. 4463, 9182). The figure of 8% was nonetheless adopted by her on the basis that it could be changed if depletion of her capital became evident (Tr. 9187). This turned out not to be required, for after four years of withdrawals at a rate of 8% per annum, her mutual fund investment was still worth 40% more than its initial cost (Tr. 9181). In addition, her high-quality individual securities, which Kibler recommended as suitable for retention had appreciated from \$25,000 to \$36,000 (Rx. 14S). These holdings of individual "blue chips" amount to approximately 50% of her security holdings (Rx. 15P).

The other Kibler client referred to in the Commission's opinion, Dr. J., a federally employed veterinarian, told Kibler that his objective was "the best possible return from our investments" (Tr. 4738). Kibler made specific portfolio recommendations (Tr. 8953). He proposed that Dr. J.'s 100 shares of Archer-Daniels-Midland be sold as the company's earnings were on a decline curve and the stock had not appreciated in the four years that Dr. J. had owned it (Tr. 8953). He also recommended the sale of 40 shares of Montgomery Ward because earnings were dropping off in the face of formidable competition from Sears, Roebuck and the stock had declined in value during the seven years in which Dr. J. had owned it (Tr. 8953-8954). Similarly, he recommended liquidation of Dr. J.'s preferred stock in Union Pacific and Southern California Gas and his United States Government bonds, on the basis that all of these securities involved fixed rates of returns and no possibility of capital appreciation and, hence, did not meet Dr. J.'s objectives (Tr. 8953-8955). On the other hand, Kibler recommended that Dr. J. retain his holdings in Liggett & Myers, Sinclair Oil, and Union Electric as appropriate to that objective (Tr. 8955-8958).

Except for the retention of 50% of his shares in Montgomery Ward,

Dr. J. followed Kibler's recommendation; \$10,000 of the proceeds were placed in Putnam Growth Fund, \$5,000 was placed in the First National Real Estate Investment Trust, and \$2,500 was placed in other securities underwritten by the firm (Dx. 515). Subsequently, Dr. J. purchased an additional \$3,000 in real estate securities, of which \$1,000 represented a Holiday Inn syndication which was being underwritten by the firm. Thirteen hundred dollars of the funds used for these two purchases was derived from the proceeds of the sale of Dr. J.'s Liggett & Myers stock, which Kibler recommended be sold after publication of the Surgeon General's report on the health hazard of cigarette smoking (Dx. 515, Tr. 8955-8956).

In 1964, Kibler recommended sale of Dr. J.'s 20 retained shares in Montgomery Ward, his 200 shares of Union Electric, which had not increased in value and showed no prospect of doing so, and his 50 shares of Sinclair Oil, which was selling at an extremely high price/earnings ratio. Kibler recommended that the proceeds from the sale of these three listed securities be invested in shares of Jones and Laughlin Steel, International Business Machines, Armstrong Cork, and American Smelting and Refining. These sale and purchase recommendations were followed by Dr. J. (Dx. 515, Tr. 8958-8959).

A. Dana Hodgdon

The Commission's opinion refers to only one of Hodgdon's customer accounts, a Mrs. W., ^{23/} who was the income beneficiary from approximately

^{23/} The Commission's opinion characterizes Mrs. W. as a financial planning client. This is a completely new assertion without any support in the record and was not the finding of the Hearing Examiner (ID at 112, JA 242).

\$700,000 in a trust account managed by a Boston bank (Tr. 1221, 1236, 1239). Mrs. W. expressed to Hodgdon her discontent with the \$20,000 a year in income which she was receiving from these trust funds (Tr. 1223, 1225) and told him that she had the power to reinvest up to \$80,000, which the Boston bank, acting as custodian, had invested in municipal bonds (Tr. 7749).

Over a period of three years, Hodgdon recommended and Mrs. W. purchased approximately \$30,000 in seasoned securities, \$15,000 in shares of Apache Realty Corporation, and \$15,000 in shares of Van Pak. The Buckingham shares were a part of an allotment to the firm which it sold as principal and the Apache Realty and Van Pak shares were sold by the firm as underwriter (Rx. O, Tr. 7750-7753).

James F. Haight

Haight, his parents, his brother, and his wife's parents made substantial investments in shares of the Aberdeen Fund and other mutual funds sold by the firm, as well as in a number of real estate and industrial securities which were underwritten by the firm (Rx. 13C-F). In addition to acting as a vice-president of the firm during the relevant period, Haight at all times personally handled 200 to 300 active customer accounts. The Commission's opinion refers to two of those accounts as supporting the conclusion that Haight was a participant in a scheme to defraud.

The first of these, Miss T., is characterized by the Commission as "an elderly woman with a high-grade diversified securities portfolio worth about \$62,000" (Op. at 12, JA 321). Miss T. testified that she had long been a purchaser of securities, having dealt with four of five different brokers (Tr. 4452,4479). She read financial periodicals, such

as the Wall Street Journal and Forbes, and was a subscriber to The Value Line Investment Advisory Service (Tr. 4555). Through her various investment activities she had run a \$10,000 inheritance into a net worth of \$81,000 (Dx. 324, Tr. 4556-4557). A substantial portion of this gain had been achieved through the purchase of speculative securities, and 30% of her "portfolio" was in shares of Cenco Instruments which she had purchased when it was a fledgling company (Rx. 12U).

Her stated investment objectives were to increase her post-retirement income and to have some further growth in her portfolio (Dx. 324, Tr. 19978). At Miss T.'s request, Haight examined her portfolio to see whether her holdings were consistent with those objectives. He gathered information concerning her securities from Standard and Poor, Value Line, David L. Babson, and Arthur Weisenberger. Haight's research notes showed the rating, stability, current dividend and other pertinent information relating to each of Miss T.'s securities (Rx. 12U, Tr. 11644).

Haight recommended that Miss T. sell 50 out of her 150 shares of General Electric because 20% of her entire net worth was in that single security (Tr. 11660). He also recommended sale of 159 of her 309 shares of Cenco because her position in that company represented 30% of her assets, the shares were then selling at 48 times earnings, the security had a below-average record of stability, and the company was then paying a dividend of 1/2% of its share's market value. Haight told Miss T. that it was grossly speculative for a 67 year old lady to have 30% of her assets in such a stock (Dx. 12U, Tr. 11656-11657). Haight also recommended sale of 50 of Miss T.'s 150 shares of Middle South Utilities in order to achieve greater diversification, a desirable characteristic which he felt was completely lacking in Miss T.'s holdings (Tr. 11661). He also recommended a sale of her 100 shares of Union Pacific which had seen no recent

growth and was then selling above its historic price/earnings ratio (Rx. 12U), 99 of her 199 shares of Electrical and Musical Industries, an English recording company about which little information was then available (Tr. 11665). He also recommended sale of her 50 shares of Bethlehem Steel because Value Line had ranked it in the worst industry group for the next five years, and it was then selling at well above its historic price-earnings ratio (Tr. 11669). He suggested sale of 75 shares of American Can, which Value Line had rated below-average in growth over the next five years and was then paying a dividend of only 1-1/2% of its market value (Tr. 11648-11650, 11666-11667).

Haight recommended that the \$20,000 of estimated proceeds from these sales should be invested in \$10,000 of Aberdeen Fund, \$5,000 in Investment Company of America, and \$5,000 in real estate securities. Miss T. did not at the time follow Haight's recommendations.

Several months later, Miss T. did invest \$5,000 in a Washington area apartment complex that was being underwritten by the firm. She made this purchase out of her cash, not out of the proceeds of the sale of any of the securities that Haight had recommended that she sell, and after she viewed the property and read the prospectus (Tr. 4576, Dx. 502). In late 1960, Miss T. sold 50 shares of Cenco and, motivated by her desire to offset the large gain on that transaction by selling securities which were then substantially below their purchase price, disposed of 75 shares of American Can, 100 shares of Union Pacific, 50 Middle South Utilities, 50 Bethlehem Steel, and 11 Continental Baking (Tr. 564, 4573). She invested the \$12,000 proceeds from these transactions in shares of Aberdeen and Investment Company of America (Dx. 502). Subsequently, Miss T. purchased another \$5,000 in Aberdeen and approximately \$55,000 of securities underwritten by the firm or sold by it as principal. Of this amount,

approximately \$47,000 was in real estate securities which Haight believed would achieve Miss T.'s objective of increasing her retirement income (Dx. 500,501).

From time to time, Haight recommended that Miss T. purchase individual listed securities including Monsanto, Sheraton, Jim Walter, Savannah Electric and Power, General Tire, Martin Marietta, and Coastal State Utilities, but Miss T. uniformly rejected these recommendations (Tr. 4513, 12105-12108). Had she accepted these recommendations, a larger portion of her portfolio would have been in listed securities, but even as it was, after four years of being Haight's client, she held approximately \$40,000 in listed securities, a substantial percentage of her overall holdings (Rx. 14L).

The other Haight customer referred to by the Commission, a Miss B., first contacted Haight expressly for the purpose of purchasing a particular real estate security which she had heard about through friends (Tr. 1750). Sometime later, Miss B. gave Haight a list of her securities and asked for his recommendations. Haight went through the same process of research and analysis that he had done for Miss T. He then recommended that she sell \$5,000 in Japanese industrial bonds because of the uncertainties attendant upon any such foreign investment, \$3,100 of Maremont, a cyclical security then selling at three times its historic price earning ratio. Haight also recommended a possible future sale of State Loan and Finance on information that the company was experiencing managerial difficulties and suggested sale of Miss B.'s Hunter Engineering and replacement of those shares with a higher grade electrical industry stock such as General Electric (Tr. 11779-11781).

During the relevant period Miss B. sold approximately \$27,000 of

securities which Haight had recommended for sale. She also sold of her own volition \$21,000 in U. S. Treasury notes and \$4,200 in Standard Oil of New Jersey (Dx. 491).^{24/} The Treasury notes were sold after she expressed great dissatisfaction with both their rate of return and their price erosion (Tr. 11778-11779). The Standard Oil of New Jersey was sold after she read an article about the possible effect on that company of then pending negotiations with the Venezuelan government. Haight recommended that part of the proceeds from the sale of her Standard Oil shares be invested in Phillips Petroleum, a domestic producer which did not have this problem and that the balance be invested in shares of Gillette. Miss B. followed these recommendations (Tr. 4833, 4840-4841, 11795, 11799-11800; Dx. 493).

At Haight's recommendation she also made investments of \$10,000 each in Aberdeen and Investment Company of America and investments totaling \$48,000 in real estate securities which were being underwritten by the firm or as to which the firm was acting as principal (Dx. 492). This comported with Miss B.'s stated preference for real estate securities and was productive of far greater returns than she was realizing on any of the securities which she sold (Dx. 432).

^{24/} The Commission's Opinion avoids this fact by ambiguously referring to \$52,000 of her portfolio which was "sold mainly on Haight's advice" (Op. p. 13, JA 322).

W. Lyles Carr

During the relevant period Carr handled from 250 to 375 accounts (Tr. 10014). The Commission points to two of these accounts as illustrating the over-all scheme to defraud (Op. p. 13, JA 322).

The first of these, a Colonel F., was referred to Carr by another client who had achieved substantial gains by following Carr's recommendations. Colonel F. asked Carr to handle his account on a discretionary basis and Carr expressed reluctance to do so. He also cautioned Colonel F. that he should not anticipate results similar to those which had been obtained by his friend (Dx. 305, 306). Colonel F. replied, again asked Carr to handle the account on a discretionary basis, and stated that his "investment philosophy [was] to buy stock in relatively young companies with a showing of growth." He further stated that he had "set an annual overall appreciation of 10% as [his] investment goal" (Dx. 308). Carr replied that while speculative investments do offer the possibility of large profits, there is also substantial danger of losses in a portfolio consisting solely of speculative investments and warned that he did not "think any more money should be put into speculations than [Colonel F.] can afford to lose" (Dx. 309). Carr proposed that Colonel F.'s account be handled in "a conservative way" and suggested putting between 50% and 80% into the Aberdeen Fund (Dx. 309). This recommendation was rejected by Colonel F. (Dx. 310). Carr then proposed that Colonel F. invest \$1,000 in any mutual fund of his choice (Carr included in his suggestion two no-load funds), another \$1,000 in a first grade real estate investment trust, and agreed that if such investments were made, he would be willing to recommend speculative securities for the balance. He further advised Colonel F. that if he insisted in investing exclusively in spec-

ulative securities, he would not and could not handle the account (Dx. 313). Colonel F. agreed to this proposal, purchased \$1,000 of Aberdeen, \$1,000 of First National Real Estate Investment Trust and five other securities, four of which were underwritten by the firm (Dx. 510). To make these purchases, Carr arranged for the sale of ten odd-lot holdings in the account of Colonel F. Of the ten selected for sale, nine sustained substantial decreases in price thereafter. In some instances the decline amounted to 75% to 90% of the price which Carr had arranged for sale of these shares, and in several other instances there was no market at all (Rx. 14K).

The other Carr account referred to by the Commission, a General A., had been Carr's client for a number of years prior to the relevant period (Dx. 359; Tr. 10181-10183). Prior to 1960, at Carr's recommendation, General A. had invested in Putnam Fund and a small number of "well established" companies (Rx. 16A; Tr. 10160-10161). In mid-1960, General A. told Carr that he had sustained a substantial business loss and wished to invest in "speculative" securities to try to realize gains before his capital loss carry forward would expire (Tr. 10167, 10216, 10221). Only thereafter did Carr's recommendations include speculative securities. Of \$33,000 in securities sold to General A. which the firm had underwritten, Carr considered some \$18,000 to be speculative. The balance was in tax sheltered real estate (Dx. 422, 423).

The Other Two Accounts

The Commission's opinion (at p. 13, JA 322) refers to only two other accounts out of the firm's total of over 10,000. The employment of the registered representative who handled these accounts was terminated in August 1961 (Rx. 13I) after it was discovered that he was

placing too heavy an emphasis on speculative securities which were inappropriate to the needs and objectives of his clients (Tr. 11890-11891).

F. Other Alleged Violations

Representations in the Sale of Van Pak, Inc.

The Commission contends that the "bullish" views of Van Pak's prospects which individual respondents communicated to their customers were misrepresentations, but respondents had every reason to be optimistic over those prospects. In June, 1961, Van Pak had Department of Defense approval to service more than 22 installations, but by December 19, 1961 it had approval to serve 580 domestic and 125 overseas installations (Dx. 52, 59; Tr. 6432). It was therefore obvious that financial figures for 1961 would not be indicative of the amount of business which Van Pak would and could do in 1962 and years thereafter. This was made manifest by the fact that Van Pak's gross volume for the fiscal year ending September 30, 1961 was only a little over \$290,000, whereas in the fourth quarter of that year, Van Pak had gross revenues of \$359,077 (Dx. 52, pp. 6-9), with a resulting net income of \$18,436 for the quarter.

Reports received from Van Pak's management after the closing date of financial information in the prospectus, revealed that Van Pak was realizing gross revenues of approximately \$150,000 a month in the relatively poor shipment months of January and February and that based upon bookings reported by field agents, March sales were estimated at \$350,000 and April's at \$600,000 (Tr. 6456-6457, 6460, 6471). An interim financial report for the five months ending February 28, 1962 showed net profits of \$32,192, after deduction of interest and factoring costs of

\$21,474, which expenses would be eliminated by the proceeds of the underwriting (Rx. 6P), and as the Hearing Examiner found, Van Pak's president was projecting earnings for 1962 of between \$1.00 to \$1.50 per share. Van Pak's liabilities exceeded its stated assets because the SEC required it to write off all of the costs of development and qualification of its shipping system, rather than capitalize these expenses as had been done by the firm's accountants in the preliminary prospectus. Nonetheless, every indication showed that Van Pak was now beginning to reap the benefit of these expenditures and by March it had generated sufficient cash from operations to pay back more than \$50,000 which it had owed to its commercial factor (Tr. 6465-6466).

With regard to the novelty of Van Pak's shipping methods, the prospectus showed that while Van Pak had not originated the containerized method of transportation, it had engaged in nearly a decade of development work in its specialty of containerized movement of household goods and was believed to be the only forwarder of household goods using metal reusable containers for domestic shipments (Dx. 52, pp. 3, 11).

The evidence as to what respondents said about Van Pak in discussing the company with their customers was sharply in dispute. The Hearing Examiner credited self-contradictory statements made by customer witnesses and rejected respondents' testimony without findings as to why he was preferring the customer's testimony (ID pp. 113-116, JA 243-246).

Van Pak's financial condition was fully disclosed in the prospectus, a copy of which was sent to every purchaser (Tr. 11738). The security was not registered in Virginia because its liabilities exceeded its assets, but the fact of non-registration said nothing material about the company, its condition, or its prospects which was not already

disclosed in the prospectus.

The Commission's opinion asserts that in view of Van Pak's "insolvency" it was unreasonable for respondents to project a favorable outlook. But what the Commission overlooks is that the \$330,000 which Van Pak would realize from the offering would put it in a healthy financial condition. And since the offering was on an "all-or-none" basis, not one nickel of investor money would be at risk unless Van Pak achieved a condition of financial health (Dx. 52).

Sales of Alleged Unregistered Securities

The evidence with respect to this issue established that the amounts involved in the three private placements were relatively small; approximately \$50,000 in the case of U. S. Infrared, \$110,000 in the case of Paragon and less than \$10,000 in the case of Data Processing. In addition, the number of offerees was in each instance less than 20. While every single offeree was not proven to be sophisticated, the record shows that most were either sophisticated investors or had special background and experience in the business of the issuers. Further, although in no instance could it be said that investors received all of the information which would have been provided to them by a full registration, they were all made aware that these were highly speculative investments in fledgling companies. All of the foregoing represent facts which in the view of petitioners were material to the question of whether the private placement exemption was available.^{25/}

^{25/} This is an addition to the argument made at pp. 54-58, infra, that in 1960 and 1961 an offering made to less than 25 persons did not require registration under the Securities Act of 1933.

Representations Concerning U. S. Infrared Corporation

Precisely what was said by Kitain to a purchaser of the security involved in this private offering was the subject of testimonial conflict. Neither the Examiner nor the Commission made findings as to why they rejected Kitain's testimony. In addition, the Commission failed to make the additional material findings that Kitain initially invested \$2,500 of his own funds and \$1,650 of his father-in-law's funds in U. S. Infrared shares, and thereafter, in the second offering of these shares, both he and his father-in-law subscribed for their maximum share allocation, and that these purchases were made at the same price at which the security was purchased by Kitain's clients (Tr. 10805-10807, 10813).

Representations Concerning Paragon Electrical Manufacturing Corporation

Precisely what was said by Carr to a purchaser of this security was a subject of dispute but the record does contain evidence from which the Commission could determine that the statements set forth on page 19 of the opinion were made. There was, however, conflict as to whether those statements were material misrepresentations. In addition, the Commission failed to make any findings with respect to the additional material fact, that the firm as its portion of the commission from the private placement of the Paragon stock received 1,000 shares of Paragon, thus putting itself in precisely the same position as those investors whose purchases had been solicited (Tr. 5873, 7643-7644).

Representations Concerning Data Processing Corporation of America

Precisely what was said by Davis to a purchaser of this security was a subject of testimonial conflict. Neither the Examiner nor the Commission made findings as to why Kitain's and Davis' testimony was

rejected. In addition, the Commission failed to make the additional material findings that neither Kitain nor Davis made any commission or other profit from the sale of these shares and both made substantial purchases for their own personal account at the same price paid by their clients.

Representations Concerning the Apache Canadian Gas and Oil Program of 1961

Precisely what was said by Harper to a purchaser of this security was a subject of dispute, but the record does contain evidence from which the Commission could determine that the statements set forth on page 19 of the Opinion were made

False Records

There was no dispute concerning the facts surrounding the marking of confirmations for Van Pak stock which had been sold to Virginia residents, and petitioners stand on the facts as found by the Commission (Op. p. 21, JA 330). However, the Commission's ipse dixit "that the use of the term 'unsolicited' where the order was in fact solicited constituted a false entry which could hamper this Commission in its investigatory functions" is simply incorrect. Since as a matter of law, an original offering pursuant to prospectus can never be "unsolicited," a proposition of which both respondents and the Commission were aware, the use of such word of the phrase "not solicited" in connection with the marking of the Van Pak confirmations could only have had the secondary meaning ascribed to it by registrant and the individual respondents (Tr. 2129, 2150, 7673, 8550, 12039).

Failure to Amend Application for Broker-Dealer Registration

The firm conceded that in three instances, the election of a

vice president and director in early 1960, the election of an executive vice president and director in late 1960, and the election of a vice president and director in May 1962, it failed to file the required amendments to its broker-dealer registration. The Commission, however, failed to find the additional material facts that these elections were clearly set forth in registrant's minute books, that the three individuals were publicly identified as officers of registrant, and that no intention to conceal their association with the registrant can be inferred.

Failure to Transmit Funds Promptly

The evidence established that some sales were made in connection with the offering of Southeastern Mortgage Investors Trust in which the funds were not "promptly transmitted" to the issuer within the meaning of Rule 15c2-4 (Op. at 22, JA 331). However, the Commission failed to find the following additional material facts.

Except for this one instance, all funds due to issuers were either escrowed or transmitted within 48 to 72 hours (Tr. 12961, 12992-12993). During the period in question registrant was converting its entire accounting system to computers and the firm's Cashier, who had always previously complied with the requirements of Rule 15c2-4, was working 60 hours a week. Transmittal of funds to issuers required the Cashier's personal verification of receipts and he was only able to do so at two week intervals (Tr. 12963-12964). None of the funds which should have been transmitted were used by the firm for general business purposes (Tr. 12973, 12985-12986). Until the Commission's staff called attention to the failure to transmit, no one at the firm other than the Cashier knew or had reason to know that transmittal had not been made in accordance with his normal practice.

ARGUMENT

THE COMMISSION'S CONCLUSION THAT REGISTRANT AND THE INDIVIDUAL RESPONDENTS ENGAGED IN A "SCHEME TO DEFRAUD FINANCIAL PLANNING CLIENTS" CANNOT BE SUSTAINED

A. Neither Substantial Evidence Nor the Commission's Findings Support its Conclusion that There Was a Violation of Law

The Commission concluded that the investment programs are a scheme to defraud by causing clients to engage in transactions in order to achieve maximum profits to the respondents.

Until its decision in this case, the Commission has always considered that an essential element of such "self-enriching" violations is proof that the commission-producing transactions were not for the customer's benefit.^{26/} Doubtless for this reason the Commission charged respondents with inducing customers, without regard to their needs and objectives, to sell seasoned securities out of their investment portfolios and reinvest the proceeds in unseasoned and speculative securities (JA 18). That issue was litigated at great length at the hearing. Yet the charge that respondents had taken their customers out of suitable securities and put them into unsuitable ones was abandoned after the

^{26/} In E. H. Rollins & Sons, Inc., 18 SEC 380 (1945), the Commission dealt with an overtrading situation in which "securities sold were often repurchased from the [customer] after a short interval, then resold to it, then again repurchased." These transactions generated \$5,553 for the broker and an \$187.50 profit to the customer. The Commission observed that the respondents had "made no effort to justify or explain the advisability of such transactions" and concluded that the broker had "profited through this practice with no apparent benefit to the customer (*id.* at pp. 380-381). Similarly, in Thomas Arthur Stewart, 20 SEC 196 (1945) and in Russell L. Irish, Securities Exchange Act Release No. 7687 (Aug. 27, 1965, aff'd 367 F.2d 637 (9 Cir. 1966), cert. denied 386 U.S. 911, the Commission's conclusion that the broker's purchase and sale recommendations were unlawful self-enrichment, was grounded on analysis of those recommendations which showed that no "benefit would be gained by the customers." And in Shearson Hammill & Co., Securities Exchange Act Release No. 7743 (Nov. 12, 1965), findings that customer accounts had been turned over from five times a year to seventy times in ten months were accompanied by express findings of unsuitability.

^{27/} hearing. As the Commission's opinion states (at p. 15, JA 324): "Neither the Examiner's conclusions, nor our own * * * rest on a determination that the securities recommended and sold were unsuitable."

Nevertheless, the Commission found respondents guilty of fraud, without, however, advancing any substitute standard by which the "customers interests" are to be measured or explaining how they were determined to have been disadvantaged in this case. For this reason alone, its conclusion cannot stand.

Moreover, an essential prop to the Commission's conclusions with respect to financial planning is its assertion that registrant held out the promise that a substantial portion of a client's funds would be placed in "long established stocks [and] bonds" the so-called "blue chips," and that such monies were placed instead in mutual funds, real estate securities, and other high commission situations. But this purported rationale is unavailable for several reasons.

First, there is no substantial evidence to support the conclusion that registrant held out to its customers that it would recommend purchase of many individual listed securities (Op. at p. 4, JA 313). The radio commercial which spoke of balance between "new opportunities" and "long-established stocks, bonds, mutual funds and the like" was the only one of its kind and therefore could hardly be said to be "representative." Moreover, as the Commission points out in the very next paragraph of its opinion (Op. at 4, JA 313), clients were told that the firm's financial planning approach would result in "about 50% of their funds being placed in mutual fund shares, 30% in "blue chips" and real estate securities,

^{27/} The order for proceedings also charged respondents with failing to disclose its "commissions" and "charges" to their customers (JA 18). Since all sales of mutual funds and virtually all sales of real estate investments were accompanied by a statutory prospectus which prominently featured the sales commission, this charge has also been abandoned.

and 20% in speculations and/or "special situations." No client who was told that could have come away with a belief that the bulk of his invested funds would be placed in individual "blue chip" stocks.

Second, some 25% of registrant's business was in listed securities. The Commission ignored the evidence that with respect to the varied customers on whose testimony it relied, respondents had recommended listed securities which in some instances were rejected by the clients themselves. Furthermore, analysis of the portfolios in those cases shows that the individual "high-grade securities" component of those portfolios was well represented by "blue chips" owned by the client before he became a customer of the firm, which were recommended for retention as suitable to the customer's stated objectives (see, supra, pp. 22, 25, 27, 28, 29, 31, 32, 33, 37, 38, 40).

But the most serious objection to the Commission's theory is its failure to explain why a recommendation that a client sell a listed security and acquire mutual funds or real estate investments is deemed fraudulent as a matter of law.

The Supreme Court held in Universal Camera Corp. v. NLRB, 340 U.S. 474, 488 (1951):

"[A] reviewing court is not barred from setting aside [an administrative agency] decision when it cannot conscientiously find that the evidence supporting that decision is substantial, when viewed in the light that the record in its entirety furnishes, including the body of evidence opposed to the [agency's] view" (emphasis supplied).

It also held in SEC v. Chenery Corp., 318 U.S. 80, 94 (1943), that:

"[T]he orderly functioning of the process of review requires that the grounds upon which the administrative agency acted be clearly disclosed and adequately sustained."

Certainly, at no point has the Commission "clearly disclosed" that as a matter of expertise, it has concluded that investments in well-managed mutual funds are not as good as an investment in any listed security or that ownership of interest in real estate is not beneficial to an investor.^{28/} In addition, that portion of the opinion which deals with the "scheme to defraud" charge is replete with innuendo used as an apparent substitute for "clearly disclosed" findings. By way of example:

- A. The Opinion quotes Carr as instructing salesmen that managers of mutual funds "could pick a blue chip stock better than they" (Op. at 5, ftn. 5, JA 314). The Commission does not say whether it has found this to be an erroneous instruction.
- B. The Opinion refers to the fact that registrant received "reciprocal business" from the mutual funds on its preferred list (Op. at 5, JA 314), but does not find that this was the basis for selection of those funds which would be on its preferred list.
- C. The Commission alludes to the fact that "Aberdeen Fund shares were sold either on a contractual plan with a front-end load, or on a lump sum basis" (Op. at 5, ftn 7, JA 314), without finding that this was unusual or improper.
- D. The Commission states that the "lumping of real estate securities * * * with blue chips was * * * designed to encourage the inference that such securities were of the same high quality as blue chips" (Op. at 5, JA 314) without finding that the real estate securities which were sold by registrant were not of high quality.
- E. The Commission quotes statements given to salesmen, which pertained to the elderly and retired "such as '54 men out of every 100 are living on friends, relatives and charity' and '50% of all Connecticut doctors who died in the last ten years died bankrupt'" (Op. at 6, ftn 9, JA 315), implying, but not finding, that these statements were false.^{29/}

^{28/} The Commission has stated that "commentary" on the "investment merits" of any particular security has "traditionally been outside the scope of the Commission's responsibilities." Report of Special Study of Securities Market, p. iv, House Doc. No. 95, Pt. 1, 88th Cong., 1st Sess.

^{29/} These and other similar statistics were obtained from mutual funds and presumably reliable public sources, e.g., Connecticut State Medical Journal, January, 1968.

When the Commission's "scheme to defraud" conclusion is analyzed in the light of the precepts of Universal Camera and Chenery, it is apparent that the scheme to defraud conclusion cannot be sustained.

B. The Commission Made Impermissible Inferences as to Respondents' General Course of Conduct

Even if the 19 customer cases referred to by the Commission (Op. at pp. 7-13, JA 316-322) showed evidence of violations of the securities law, they represent a minute portion of registrant's 10,000 accounts. The Commission does not suggest that these 19 cases were selected at random and represent a statistical cross section of the whole, and, of course, this was not the case.

Requirements of "substantial evidence" would alone preclude the inference that because something happened in 19 instances it happened in 10,000 or even a substantial portion of 10,000. And in this case, the Commission was barred from drawing such an inference by rulings at the hearing. As we have shown (supra, pp. 6 - 7) respondents attempted to elicit testimony from the Commission's staff attorney who had been in charge of the investigation with respect to the scope of that investigation, the number of client cases that had been examined and the general attributes of those cases. Respondents stated that such evidence was being elicited because they feared that otherwise inferences as to a general course of conduct might be drawn from the relatively few customer cases as to which the Commission had adduced evidence. The Commission's staff objected to the inquiry on the grounds of executive privilege and the Examiner sustained the objection giving assurance that no general inferences would be drawn from these customer cases.

The Examiner's statement and ruling led respondents to conclude that evidence with respect to the other 9,981 cases was not required and, if offered, would be rejected, and being required to defend on so many

other charges and aspects of the case (see supra, pp. 5 - 8), respondents turned their attention elsewhere. Then, despite the ruling and assurances, the Examiner and the Commission both proceeded to draw broadscale inferences from these 19 cases.

The Examiner's ruling and assurance denied respondents their right to "notice and an opportunity to be heard" as secured by the Due Process Clause of the Constitution and Section 5 of the Administrative Procedure Act, 5 U.S.C. §554; Northeastern Indiana Building & Construction Trades Council v. NLRB, 122 U.S. App. D.C. 220, 352 F.2d 696, 698-699 (1965), and cases cited therein; NLRB v. Johnson, 322 F.2d 216 (6 Cir. 1963).

In the latter case, the Examiner received evidence introduced for one purpose and then relied on that evidence to find a violation not charged in the complaint, even though he had assured the respondent that the evidence was not being received for that purpose. In denying enforcement of the Labor Board's order relating to that finding, the court noted it was presented with "a question of fundamental fairness" as to which "[r]easonableness [was] the touchstone," 322 F.2d at 219, and that the respondent was not reasonably apprised of the issue it was obliged to meet. The same is true here, and for this reason the course of conduct findings should not be permitted to stand.

C. There Was No Substantial Evidence to Establish that Each Individual Respondent Knowingly Participated in a Fraudulent Undertaking

The Commission concluded that respondents' adoption and implementation of Hodgdon's financial planning concepts made them each participants in a "scheme to defraud" (Op. at 14, JA 323).

To find a joint "scheme to defraud" it is necessary to prove that each person knowingly participated in an agreed upon course of

fraudulent conduct. Kaplan v. United States, 18 F.2d 939, 943 (2 Cir. 1927); Sherwood v. United States, 300 F.2d 603, 605 (5 Cir. 1962). The question is whether "the record in its entirety * * *, including the body of evidence opposed to the [Commission's] view" furnishes "substantial evidence" to support the ultimate finding that all had joined in a "scheme to defraud." Universal Camera Corp. v. NLRB, 340 U.S. 474, 488.

The record shows that "financial planning" as advocated by Hodgdon was a reasonable investment concept. It was also reasonable for the individual respondents to believe that mutual funds were superior investment vehicles to unmanaged holdings in individual securities; that it was desirable for people to invest in quality real estate; that if people were going to speculate they should do so in relatively small amounts which would be primarily invested in local situations; that "cash value" life insurance is a poor investment vehicle; and that "oil and gas" programs are desirable for high bracket tax payers.

As it cannot be shown that the concept of financial planning was inherently fraudulent, it was incumbent upon the Commission to establish that respondents intended and agreed to use that concept as a vehicle to defraud registrant's customers. Respondents' only concerted action was in advocating financial planning and selling mutual funds and securities underwritten by registrant, mostly involving real estate investments. This provides no basis for inferring an "agreement" among respondents to utilize the concept of financial planning in such a way as to constitute a scheme to defraud, and, therefore, the conclusion that respondents engaged in a joint "scheme to defraud" is clearly erroneous. Armstrong, Jones & Company, Securities Exchange Act Release No. 8420 (October 3, 1968) p. 12, n. 27; Richard J. Buck & Co., Securities Exchange Act Release No. 8482 (December 31, 1968).

THERE WAS NO VIOLATION IN THE
SALE OF UNREGISTERED SECURITIES

The Commission erred in finding registrant and Hodgdon, Amann, Carr, Kitain and Davis to have wilfully violated Section 5 of the Securities Act, 15 U.S.C. §77d, in connection with the sale of unregistered securities of Paragon, U. S. Infrared and Data Processing Corporation of America (Op. at 20-21, JA 329-330). We submit (a) these transactions were exempted as a "private offering" under §4(1) of the Act by virtue of an SEC regulation then in effect so that Section 19 of the Act bars the imposition of sanctions, and (b) the Commission did not make the findings necessary to establish non-exemption even under the construction of the regulation which its decision adopts.

A. The Securities Involved Were Exempt from Registration

The Act does not define a "private offering" and a former director of the Division of Trading and Exchanges (now the Commission's General Counsel) has observed: "The question of what is a private offering * * * has vexed the Commission and the Bar from the beginning." Loomis, Enforcement Problems Under the Federal Securities Laws, 14 Bus. Law. 665, 669 (1959). At the time these securities were offered for sale, Part 231.285 of the Commission's "Interpretative Release Relating to the Securities Act of 1933 and the General Rules and Regulations Thereunder," as published in the Federal Register, provided:

"The opinion has been previously expressed by this office that an offering of securities to an insubstantial number of persons is a transaction by the issuer not involving any public offering, and hence an exempted transaction under the provisions of Section 4(1) of the Act. Furthermore, the opinion has been expressed that under ordinary circumstances an offering to not more than approximately twenty-five persons is not an offering to a substantial

number and presumably does not involve a public offering." 11 Fed. Reg. 10946, 10951 (1946) (emphasis added).^{30/}

The regulation then proceeds to detail a number of other circumstances which are material to a determination of whether a particular offering is "private" and thus exempt, or "public" and thus subject to registration requirements.

Respondents understood this regulation to mean that in the absence of extraordinary circumstances -- not found to have been present here -- an offering to not more than 25 persons was exempt under this regulation, and the additional circumstance would become material when the number of offerees exceeded 25. In this case the Commission held to the contrary. It implies that the regulation was no longer binding due to the Supreme Court's decision in SEC v. Ralston Purina, 346 U.S. 119 (1953), which was issued after the regulation was adopted; and it said the registrant misinterpreted the regulation. "Aside from the fact that the landmark Ralston Purina decision was issued in 1953, long before the transactions at issue here, respondents' asserted reliance on the interpretation published in the 1946 Federal Register was wholly misplaced since it was based on an excerpt taken out of context. That interpretation specifically states that 'the determination of what constitutes a public offering is essentially a question of fact, in which all surrounding circumstances are of moment. In no sense is the question to be determined exclusively by the number of prospective offerees.'" (Op. at 20, JA 329).

Professor Loss, a leading expert on the securities laws, writing after Ralston Purina, and shortly before the transactions challenged by

^{30/} The quoted provision was initially issued as Securities Act Release No. 285 (1935) and is an opinion of the Commission's then General Counsel. The 1946 publication in the Federal Register is accompanied by a statement that the published material is intended "for the guidance of the public" and that material which was then obsolete has been deleted. 11 Fed. Reg. 10947.

the Commission, summarized the state of the private offering exemption to be in accord with the registrant's view, not those espoused herein by the Commission:

"* * * notwithstanding the theoretical possibility under the Ralston approach that an offering even to a handful of persons selected at random might be a "public offering" if they were not able to "fend for themselves," it seems relatively safe to assume that an offering to not more than some twenty-five persons will be considered exempt * * * and that the other factors become important only when it is desired to approach a greater number of offerees." 1 Loss, Securities Regulation 664 (1961).

If the Ralston Purina decision had disapproved the rule stated in the Commission's regulation, or had rendered it obsolete in any way, the Commission presumably would have issued a new regulation. The Commission did not do so. Indeed, it prevailed in the Ralston Purina case on a submission which explained the exemption in a way which accords with Professor Loss' view and those of the individual respondents:

"The commission has construed the exemption with major emphasis on whether the offering is calculated to reach a substantial number of 'the public' sought to be protected. The Commission has rarely acquiesced in a claim for exemption where as many as a hundred offerees have been involved and then only in circumstances where for special reasons the protections of the act appear not to be necessary. * * * A 1934 published opinion of the Commission's then General Counsel * * * indicated that an offering designed to reach less than 25 ultimate purchasers would normally be regarded as within the exemption." 31/

See also, H.R. Rep. No. 1542, 83rd Cong., 2d Sess. 19 (1954); Orrick, Some Observation on the Administration of the Securities Laws, 42 Minn. L. Rev. 25, 33 (1957).

31/ Brief for Petitioner, Securities and Exchange Commission v. Ralston Purina Co., No. 512, Oct. T. 1952, p. 13 and n. 14 (emphasis added).

There were at least 1588 offerees in the Ralston Purina case, and in explaining how the regulation and the Ralston Purina decision are properly harmonized and construed to give effect to the regulation's "25 offeree" language as well as to the other criteria Professor Loss stated:

"[I]t is worth noting * * * that the Court's rejection of a quantity limit was not directed to a number below which an offering might be deemed private. It was by way of reply to the Commission's argument that the substantial number of offerees in the Ralston case conclusively established without more that the offering was public. In other words, the Court rejected a rule of thumb on the top side, not the bottom side." Loss, supra, at 660-661 (footnote omitted).

The Commission's present interpretation of its regulation, by emphasizing additional criteria to be considered, renders meaningless the regulation's reference to 25 offerees and its statement that an offering so limited is ordinarily not an offering to a "substantial number" of persons and, hence, is a non-public offering within the statutory exemption. Of course, the Commission was not required to adopt the interpretation of the exemption provision which is embodied in the 1946 regulation. But this does not make the regulations which it did adopt any less binding. See, e.g., Accardi v. Shaughnessy, 347 U.S. 260 (1954); Service v. Dulles, 354 U.S. 363 (1957); Sangamon Valley Television Corp. v. United States, 106 U.S. App. D.C. 30, 269 F.2d 221, 224-225 (1959). Indeed, quite apart from the binding effect of the regulation on the Commission under the Accardi principle, registrants are protected from sanctions for conduct consistent with that regulation by Section 19 of the Act which provides:

"No provision of this subchapter imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded

or be determined by judicial or other authority to be invalid for any reason." 32/

This same section renders it irrelevant that the Commission in November 1962 promulgated additional regulations pertaining to the private offering exemption, Securities Act Release No. 4445, 29 Fed. Reg. 11316, and since that time has decided several cases which cast doubt on the continuing viability of the 25 offeree test. The Commission and its staff have now operated with the different exemption standard for over eight years and perhaps they here confused the by-now familiar with the necessary. This is one of the hazards of proceedings based on hoary transactions. But Section 19 of the Act clearly protects registrants from having the legality of their conduct judged by regulations which were not then in effect.

From the foregoing, we think it plain that registrant and the individual respondents had an adequate basis for a good faith belief that the offerings were exempt, and there was no reason for them to doubt the availability of that exemption until the issuance in November of 1962 of additional interpretative regulations. Those regulations, under the plain mandate of Section 19 of the Act, cannot be retroactively applied to the consummated 1960-1961 transactions.

B. The Commission Failed to Make Factual Findings Essential Under its Own Reading of the 1946 Regulation

Even if respondents were wrong in their reliance on the Commission's "25 offeree" regulation, and even if Section 19's "good faith reliance" defense was unavailable, the Commission's conclusion that respondents violated the Act in the sale of unregistered securities would nevertheless have to be reversed. Even under the Commission's

32/ The record clearly shows that registrant's officers shared the belief then prevalent among scholars and in the industry that an offering to fewer than 25 persons was exempt (Tr. 7630-7632; 7739-7740; Dx. 1).

reading of the 1946 release, "the determination of what constitutes a public offering is essentially a question of fact, in which all surrounding circumstances are of moment" (Op. at 20, JA 329). If the question is in "no sense * * * to be determined exclusively by the number of prospective offerees" neither is it to be determined exclusively by whether each offeree received or had access to all of the information that would have been provided by yet full registration under the Act. Yet inexplicably the Commission's findings stop there.

We recognize, of course, that the burden of establishing the availability of the exemption rested on respondents. It was for this reason that respondents offered evidence as to all of the factors which were said to be relevant: (1) the limited number of offerees, and their relationship to each other and to the issuer; (2) the limited number of units offered; (3) the modest sizes of the offerings; and (4) the manner of offering.

The Commission was presented with a clear claim to the private offering exemption under the most strict reading of Ralston and the implementing regulations. On this record, the Commission's conclusion that the exemption was not available, and hence that respondents violated the Act, cannot be supported, for there were no findings as to these facts which the Commission says are material. And on that basis alone, this branch of the Commission's order must be reversed.

THE COMMISSION'S CONCLUSION THAT FRAUDULENT
REPRESENTATIONS WERE MADE WITH RESPECT TO
VAN-PAK CANNOT BE SUSTAINED

The Commission's determination that respondents made fraudulent misrepresentations in the sale of Van-Pak stock turns on two interrelated propositions. First, that respondents made specific predictions of price increases, and second, that such predictions were inherently

fraudulent. The question of what exactly respondents had said to their customers during telephone conversations which had taken place some five years earlier was sharply contested. In many respects investor testimony was self-contradictory or in conflict with written statements that had been given in response to the questionnaire which the Commission had sent to all Van-Pak purchasers in 1962. Nonetheless, the Examiner accepted the customer testimony and rejected all contradictory testimony by respondents (ID at 110-118, JA 240-248), and he did so without stating why. Indeed, he did not even appear to recognize the existence of a conflict with regard to the making of specific predictions of price increase.^{33/}

The Examiner, just like the Commission itself, is required to state "the reasons or basis" for his "conclusions." Section 8, Administrative Procedure Act, 5 U.S.C. §557(c); Brotherhood of Maintenance of Way Employees v. United States, 221 F.Supp. 19 (E.D. Mich. 1963), aff'd per curiam, 375 U.S. 216. "Where oral testimony is conflicting or subject to doubt of its credibility, the credibility of witnesses would be a necessary finding if the facts are material." Sen. Doc. No. 248, 79th Cong., 2d Sess. 210-211, 273 (1946); 2 Davis, Administrative Law Treatise, 438; NLRB v. Scott Paper Co., __F.2d__, 76 LRRM 2965, 2968 (1 Cir. 1971).

Although the issues were most material, the Examiner did not make such findings. The Commission tries to repair this defect in the adjudicatory process by stating that the Examiner "observed [the] demeanor" of the witnesses but it is pure supposition on its part that this was the reason why he presumed that the customers could recall exactly what

^{33/} The same is true of findings of misrepresentations in the sale of other securities which turned on questions of credibility (see, supra, pp. 44 - 45), and for the same reasons such findings cannot be sustained.

was said five years ago despite the conflicts in their own testimony and respondents testimony to the contrary. This is particularly so since it cannot even be said that the Examiner recognized that there were testimonial conflicts requiring resolution. Cf. Klopp v. SEC, 427 F.2d 455, 460 (6 Cir. 1970).

We have also shown at pp. 41 - 43, supra, that when respondents expressed optimism over Van-Pak's future prospects they had a reasonable basis to do so. A securities salesman does not violate the law when he has a "reasonable ground" to believe that his statements about a security are true (Rule 15c1-2(b)), and here, unlike the situation presented in Nees v. SEC, 414 F.2d 211, 219-220 (9 Cir. 1969) and Shearson, Hammill & Co., Securities Exchange Act Release No. 7743 (Nov. 12, 1965) at p. 20, respondents did have a reasonable basis upon which to express such optimism. Accordingly, they did not violate the law.

THE COMMISSION'S ACTIONS WERE
TAINTED BY PREJUDGMENT

As we have shown, supra, pp. 2, 10, the Commission's present findings and conclusions that respondents had employed financial planning as a guise to defraud their customers into purchasing high commission securities, virtually parrot the 1963 Report of the Commission's Special Study of the Securities Market. In transmitting the report to Congress, the Commission stated that "it discloses many problems [to which] we will now turn our attention. * * * [M]uch of the action may be taken * * * through exercise by the Commission of existing powers * * * " (id. at p. ix). In the exercise of that power the Commission then ordered an investigation into that which had already been found in a non-adjudicatory proceeding, on the conclusion of that investigation it converted its prior findings into charges, it repeatedly refused

to allow the proceedings to be conducted out of the white heat of publicity, and it then reiterated the initial findings.

On the basis of the foregoing, it is clear that this proceeding has the earmarks of a process characterized by a "determined purpose to reach a predetermined end * * * ." Continental Box Co. v. NLRB, 113 F.2d 93, 96 (6 Cir. 1940); see also Texaco, Inc. v. FTC, 118 U.S. App. D.C. 366, 336 F.2d 754, 760, 764 (1964), vacated and remanded on other grounds, 381 U.S. 739; Amos Treat & Co. v. SEC, 113 U.S. App. D.C. 100, 306 F.2d 260, 267 (1962); American Cyanamid Co. v. FTC, 363 F.2d 757, 763-768 (6 Cir. 1966). As was said in Amos Treat, *supra*:

"[A]n administrative hearing of such importance and vast potential consequences must be attended, not only with every element of fairness but with the very appearance of complete fairness. Only thus can the tribunal conducting a quasi-adjudicatory proceeding meet the basic requirement of due process."

It is not necessary to show that the Commission's actions have been the product of vindictiveness. It is enough that, consciously or subconsciously, their deliberations have been effected by a tendency to reach one result rather than another. Certainly, a reasonable observer would conclude that there is at least the "appearance" that the Commission's deliberations might be infected by such a tendency.

The "rule of necessity" did not require that the Commission act as the triers of fact. Respondents are all registered with the National Association of Securities Dealers and are subject to appropriate disciplinary action by that body. Since continued NASD membership is for all practical purposes essential if broker-dealers are to remain in the securities business, and since the NASD's arsenal of sanctions includes the power of expulsion, disqualification of the Commission in this case

would not, as in Cement Institute, 333 U.S. 683, 702-703 (1948), immunize respondents' conduct.

If the Commission was not disposed to refer the matter to the NASD, it still had another alternative which would have eliminated the problem of institutional prejudgment from this proceeding. That alternative was to present the facts to a federal court in an action to enjoin respondents from violating the federal securities laws. See Section 21(e) of the Securities Exchange Act and Section 20(b) of the Securities Act. If successful in such action, the Commission thereafter could have taken appropriate action to bar respondents pursuant to Section 15(b)(5)(c)-(d) and Section 15(b)(7) of the Securities Exchange Act.^{34/}

While in an ordinary case the Commission has discretion as to the choice of the remedies available to it, it is clearly an abuse of that discretion to choose a method which denies respondents due process of law. Under these circumstances the very least that the Commission should have done was refer adjudication of the scheme to defraud charges to another tribunal and retain jurisdiction over the other charges.^{35/} Such an action would at least have produced the appearance of fairness.

Since it failed to do so, the minimal remedy is vacation of the scheme to defraud findings and conclusions.

^{34/} See, e.g., A.G. Bellin Securities Corp., 39 SEC 178, 186 (1959); Administrative Procedure in Governmental Agencies, The Securities and Exchange Commission, Sen. Doc. No. 10, 77th Cong., 1st Sess. (1941), Part 13, pp. 8-9; Weiss, Registration and Regulation of Brokers and Dealers, 226-228.

^{35/} It would have also avoided the protracted hearing which in and of itself was a denial of due process (see, infra, pp. 64 - 66).

THE ORDER FOR PROCEEDINGS WAS SO BROAD AS
TO DEPRIVE RESPONDENTS OF FAIR NOTICE AND
DUE PROCESS OF LAW

In ostensible compliance with respondents' statutory and constitutional right to fair notice, the Commission entered an order for public proceedings which was breathtaking in its scope (JA 16 -21). Charged in the literal language of the statute and implementing regulations, respondents were, in effect, informed that they had broken "every rule in the book" with respect to every customer and securities transaction in which they were involved during a fifty-month period.

Respondents' efforts to narrow the scope of the proceeding were rebuffed at every turn. An attempt to limit the alleged deficiencies of its training program to the allegation that salesmen were not indoctrinated in the "standards of conduct required" of those who engaged in the securities business" was met with the assertion that the agency contended that the training program was also technically defective in every respect. Seeking to narrow the charge that they had induced (and permitted others to induce) customers, without regard to their needs and objectives to sell their seasoned securities and to purchase unseasoned and speculative ones, respondents, by motion for a more definite statement, asked: "Which customers? What seasoned securities? What unseasoned and speculative securities?" (JA 55-74). The Examiner granted the motion in part, requiring the identification of the unseasoned and speculative securities, but he refused to particularize either the names of the customers or the "seasoned" securities which they had wrongfully been induced to sell.

Respondents were forced to trial on an order that set forth innumerable legal theories as to an unstated number of unnamed customers

who had been improperly induced to sell securities. And as particularization of the alleged unseasoned and speculative securities which such unnamed customers had been induced to buy, the Commission's staff named almost every security which respondent had sold.^{36/}

Thus was launched a hearing that would consume 108 days. Respondents attempted to defend against all the charges. The broad-scale attack on alleged representations in the sale of real estate was met with an equally broad scale defense. The attack on respondents' training program was met with extensive evidence to show the nature and scope of respondents vast training activities. The attack on respondents' allegedly inadequate supervision was met with lengthy testimony as to the methods which were employed and as to what was achieved by those methods. The attack on respondents' sale of 44 allegedly unseasoned and speculative securities was met with proof as to the intrinsic merits of those securities. The proceeding itself was grueling and financially debilitating punishment. When respondents were required to defend themselves on all these grounds, dictates of time and money precluded a maximum defense effort as to anyone of them.

An order that permits that kind of open-ended hearing does not accord the fair notice of the issues of fact and law which are to be adjudicated. Morgan v. United States, 304 U.S. 1, 18 (1938); Douds v. International Longshoreman's Ass'n., 241 F.2d 278, 283 (2 Cir. 1957); NLRB v. Tennesco Corp., 339 F.2d 396, 399 (6 Cir. 1964); Burkett v. United States, 402 F.2d 1002, 1004-1007 (Ct. Cl. 1968).

The prejudice inherent in such an order becomes manifest when the agency, as the Commission has done here, abandons most of the

^{36/} At the hearing, the Commission's counsel tried to add seven more securities, but the Examiner refused to let him do so (JA 97).

charges and reformulates its principal theory of violation. "This is not to [argue] that the inclusion of superfluous or irrelevant material automatically invalidates the notice, but only that the notice is bad where such extraneous material, which should not have been included, significantly hobbles, complicates, or prejudices the [respondents'] defense." Burkett v. United States, 402 F.2d 1002, 1007 (Ct. Cl. 1968); Rodale v. FTC, U.S. App. D.C. , 407 F.2d 1252, 1256-1257, 1258 (1968).

THE SANCTION PHASE OF THE PROCEEDING
IS INFECTED WITH PREJUDICIAL ERROR

The 1970 finding that petitioners violated the securities laws between 1961 and mid-1964 triggered the Commission's statutory obligation to consider what sanction, if any, was appropriate in the public interest. The Commission's sanction finding, like any other administrative finding, must articulate the grounds on which it is based. Beck v. SEC, 413 F.2d 832 (6 Cir. 1969); 430 F.2d 673 (6 Cir. 1970). Since an administrative sanction must be remedial, not punitive, the sanction must operate prospectively to protect the public interest--not retrospectively to punish the respondent. E.g., Beck v. SEC, supra. Because this is so, the sanction should be based on a fresh record which reflects the state of the facts as of a point in time reasonably contemporaneous with the imposition of the sanction. Beck v. SEC, supra, 413 F.2d at 83; Ross Securities, 41 S.E.C. 509, 517 n. 10 (1962). The Commission's sanction order in this case is fatally defective on all these grounds.

A. The Commission Punished Respondents for
Insisting on an Administrative Hearing.

Straining to distinguish cases which respondents had cited to demonstrate that far less severe sanctions had been imposed for far more

serious violations, the Commission made a most extraordinary admission.

It said:

"The cases cited by [respondents] to show discrimination in the imposition of sanctions do not support their position, and a number of them involved settlements. In settlement cases, where as a rule there is no admission of violations, we take into account pragmatic considerations such as the avoidance of time- and manpower-consuming adversary proceedings." (Op. at 27, JA 336) (Emphasis added.)

The Commission has thus declared that if a litigant insists on his statutory and constitutional right to "time- and manpower-consuming adversary proceedings" he can expect a harsher sanction than had he admitted the violation, settled the case, and saved the agency some time and effort.

An administrator, no more than a judge,^{37/} cannot penalize one's insistence on his hearing rights by such crass tactics. Cf. North Carolina v. Pearce, 395 U.S. 711 (1969). We think it incontestible that a sanction ought to be imposed on the basis of the facts of record, not on "pragmatic considerations" such as the Commission admits it considered here.

Because the Commission's own opinion shows that a forbidden factor entered the sanction phase of the proceeding, its order cannot stand.

B. The Sanction Order Lacks Adequate Findings.

In his Initial Decision, the Examiner made specific findings on the public interest aspect of the case. For example, with respect to registrant, the Examiner found:

^{37/} United States v. Wiley, 278 F.2d 500 (7 Cir. 1969); Short v. United States, 120 U.S. App. D.C. 165, 344 F.2d 550 (1965); Cf. Thomas v. United States, 368 F.2d 941 (5 Cir. 1966).

"The defense of this proceeding has involved great expense. Since July 1964 registrant has altered its policies and practices. It does not engage in private placements. Its listed business has increased to 58% of its sources of income. Registrant no longer underwrites real estate limited partnerships or small speculative industrial enterprises. As of 1966 participation as an underwriter or selling group member represented about 5% of its gross volume. Securities research is now provided by member firms of the NYSE. Further, registrant has imposed more stringent controls over its personnel, has taken other steps to assure adequate supervision of customers' accounts, adherence to financial plans and no excessive activity or large commitments in speculative securities. It has installed a system for monitoring telephone calls, permits no discretionary accounts except under extraordinary circumstances and has employed an attorney on a full time basis whose functions relate to regulatory matters and to assist Haight in the supervision of sales activities. Haight now devotes 80% of his time to managerial duties." (ID at 140, JA 270).

The Examiner made specific findings to support his conclusion that the conduct of the individual respondents warranted sanctions of less than lifetime bar.^{38/}

On review, the Commission rejected none of these findings, and it explicitly acquitted all respondents of misrepresentation of real estate returns--a key consideration to the Examiner's conclusion that respondents had violated the securities laws (Op. at 28, n. 50, JA 337). Yet, the Commission increased all sanctions to immediate and permanent exclusion from the securities industry. Its supporting finding for this extraordinary sanction is found in a single sentence: "We conclude

38/ The finding with respect to Kibler is typical:

"Kibler's financial planning accounts were 'loaded' and he misrepresented real estate returns. The record shows no other misconduct in respect of these clients. But he also made serious misrepresentations in the sale of Van Pak stock. He should be barred from association with any broker or dealer for five months." (ID at 144, JA 274).

that the various mitigative factors cited are insufficient to overcome the serious fraud and other violations of the respondents" (Op. at 28, JA 337).

Such a "finding" is no finding at all. SEC v. Chenery Corp., 318 U.S. 80, 94 (1943). The Chenery doctrine has been specifically applied to Commission sanction orders such as the one involved here. Beck v. SEC, 413 F.2d 832 (6 Cir. 1969); cf. Phelps Dodge Corp. v. NLRB, 313 U.S. 177, 196-197 (1941). Here, as in Beck, there is no reasoned articulation of the reasons why the public interest requires summary exclusion from a securities industry for violations which approach being a decade old. As this Court has previously held, the agency "must find what the statute requires it to find, not in conclusory fashion in the statutory language but in such fashion that a reviewing Court can test the validity of the finding." American Airlines, Inc. v. CAB, 98 U.S. App. D.C. 348, 356, 235 F.2d 845, 853 (1956); Fan American World Airways v. CAB, 104 U.S. App. D.C. 288, 261 F.2d 754 (1958).

C. The Commission's Order Is Retrospectively Penal Instead of Prospectively Remedial.

In 1971, the Commission finally concluded that respondents had violated the securities laws and regulations in 1961-1964. The Commission's conclusion that this conduct, some of it a decade old, required respondents' immediate and permanent exclusion from the securities industry suffers from two fatal defects. First, this record is so stale that no remedial order can now be entered. Second, the Commission's repeated refusal to update the administrative record, requires reversal of the sanction in any event. We treat the points separately.

1. The Record Is Too Stale.

This is a classic case of administrative lethargy. In 1961, the Commission instituted the Special Study pursuant to the provisions of 15 U.S.C. §78s(d). In 1963, it forwarded its "Report of Special Study of the Securities Markets," H. Doc. No. 95, 88th Cong., 1st Sess. (1963), to the Congress. In that report, singling the registrant out by name, the Commission suggested that its methods of doing business were violative of the law. Report at 109-110, 261-262 (1963). Another year--and more--passed before the Commission issued an order for investigation. A year and a half of administrative investigation passed before the Commission finally issued its order for public proceedings--the administrative equivalent of a complaint--in 1966. That order was so broad, a proposition discussed in detail elsewhere, supra, pp. 64-66, that it took another five years to conclude the administrative hearings and review process. Finally, in 1971 the Commission concluded that respondents had committed some securities violations a decade earlier. It imposed a capital sanction.

We think this kind of delay is exactly the situation which the Court had in mind when it pointed out that an administrative record can become so stale as to permit no other course but outright dismissal. Rodale Press, Inc. v. FTC, U.S. App. D.C., 407 F.2d 1257-1258 (1968). This record will not support a conclusion that the public interest will be harmed in any way whatever by respondents being permitted to pursue their vocations in the securities industry. The administrative record, stagnant for these many years, cannot bridge the time gap. The proceeding ought to be dismissed.

2. The Commission Erred in Refusing to Update the Record.

The administrative record closed in 1967. Based on evidence presented during the hearings as to respondents' methods of doing business between 1964, the latest date on which a violation was charged, and 1967, when the hearings closed, the Examiner recommended, in a number of instances, sanctions other than outright revocation (ID at 143-144, JA 273-274).

The last violation with which respondents were charged occurred in 1965. The Hearing Examiner's Initial Decision was not rendered until 1969. Even so, the Examiner concluded that evidence of 1964-1967 conduct warranted sanctions other than outright revocation in a number of instances (JA 140-147). Respondents immediately sought leave to reopen the record for the limited purpose of adducing evidence of 1967-1969 conduct as bearing on the public interest issue. The motion was denied by the Examiner, and that denial was affirmed by the Commission on ^{39/} review. When the case went to the Commission, respondents renewed

^{39/} The law is unclear as to when an administrative litigant is entitled to, or must, seek judicial review of an agency order declining to reopen the record and receive additional evidence. Compare Consolidated Edison Co. v. National Labor Relations Board, 305 U.S. 197, 225-226 (1938), and Communist Party v. Subversive Activities Control Board, 102 U.S. App. D.C. 395, 403-405, 254 F.2d 314, 322-324; 107 U.S. App. D.C. 279, 281-282, 277 F.2d 78, 81, aff'd., 367 U.S. 1 (1961), with Texaco, Inc. v. FPC, 117 U.S. App. D.C. 268, 329 F.2d 226, cert. denied, 375 U.S. 941 (1964) and Reuben Rose & Co. v. SEC, No. 19,278 (D.C. Cir., order entered June 29, 1965). To obviate any jurisdictional problem, registrant and respondent Haight timely filed a petition to review, and a motion to reopen the record and adduce additional evidence, after the Commission denied the post-Initial Decision motion. See Haight & Co., Inc. v. SEC, Nos. 23,244 and 23,246. The parties thereafter stipulated that all further proceedings in those appeals be held in abeyance pending final agency action. Acting Chief Judge Wright approved the stipulation by order. Thereafter, when the petition for review of the final agency order (No. 71-1136) was docketed here, the parties jointly moved for an order of consolidation, and Chief Judge Bazelon granted that motion. Accordingly, whatever view of the jurisdictional issue the Court may embrace, the issue is properly here.

that request. In 1971, the Commission handed down its opinion. Ironically, it refused to receive this evidence on the ground that it would result in an "unwarranted prolongation of the proceedings * * *." (Op. at 27, n. 48, JA 336). This was error.

Evidence of post-violation conduct is highly relevant on the public interest issue. Beck v. SEC, supra; Ross Securities, 41 S.E.C. 509, 517, n. 10 (1962). In the usual case, the agency may be expected to proceed with reasonable dispatch, and the violation record will be sufficiently fresh as to warrant a public interest determination. Not so here. The public interest record was four years stale when the Commission finally denied respondents' request for leave to adduce additional evidence. Its public interest conclusion, therefore, cannot stand. There is simply no evidence in this record to sustain a conclusion that respondents must be barred from the securities industry in 1971, for violations which occurred, if at all, seven to ten years earlier, on a record which contains no evidence as to respondents' method of doing business during the past four years.

CONCLUSION

For all of the foregoing reasons, the Commission's order imposing sanctions should be reversed and the administrative proceeding should be ordered to be dismissed.

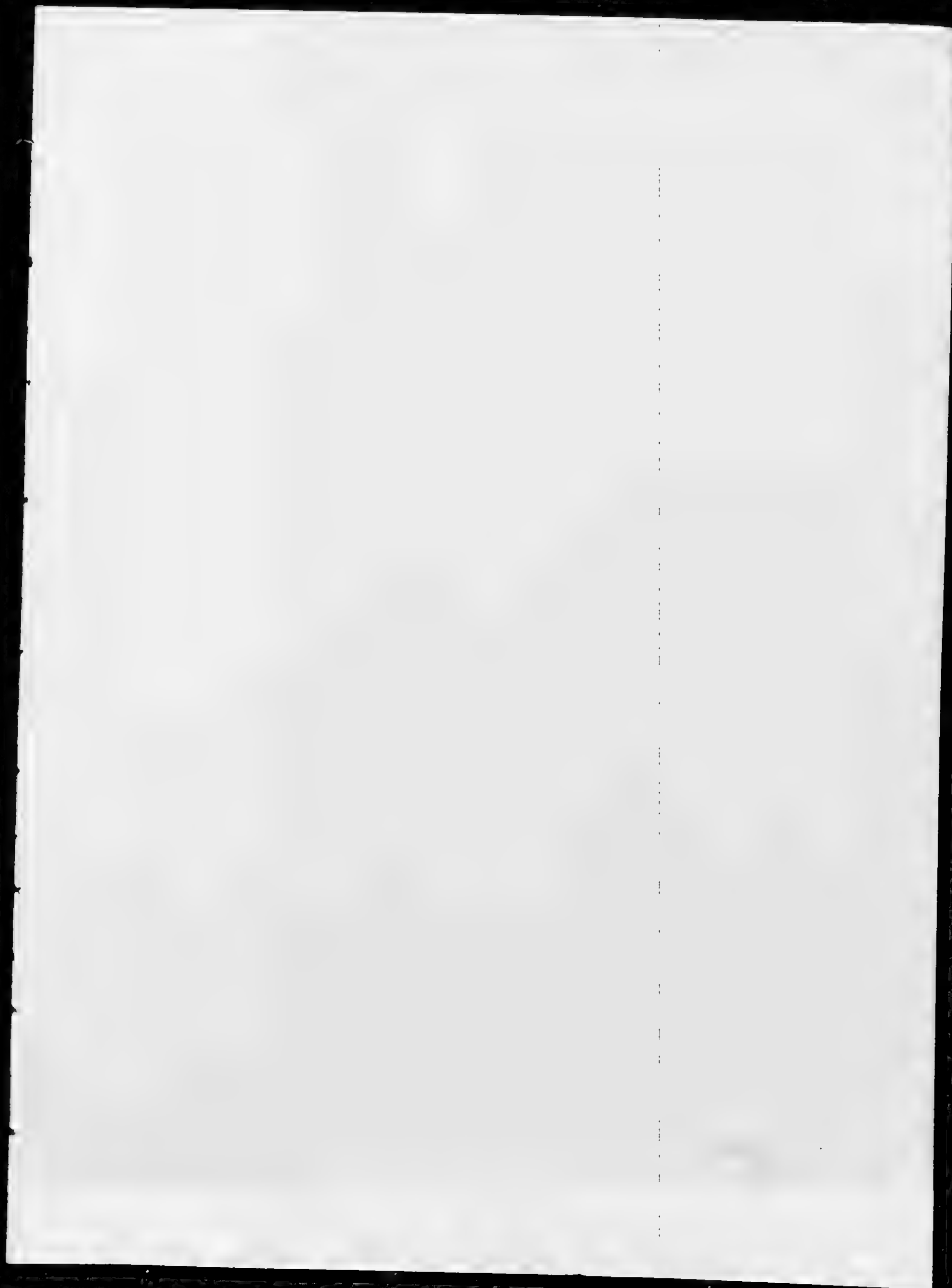
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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 23,244, 23,246, 71-1136
(Consolidated)

HAIGHT & CO., INC.,
A. DANA HODGDON,
JAMES F. HAIGHT,
BURTON KITAIN,
W. LYLES CARR, JR.,
JAMES W. HARPER, III,
DAVID M. ADAM, JR.,
HOMER E. DAVIS, and
ROBERT F. KIBLER,

United States Court of Appeals
for the District of Columbia Circuit

FILED JUN 9 1971

Nathan J. Paulson
CLERK

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of Orders of
the Securities and Exchange Commission

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 23,244, 23,246, 71-1136

HAIGHT & CO., INC.
A. DANA HODGDON,
JAMES F. HAIGHT,
BURTON KITAIN,
W. LYLES CARR, JR.,
JAMES W. HARPER, III,
DAVID M. ADAM, JR.,
HOMER E. DAVIS, and
ROBERT F. KIBLER,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of Orders of
the Securities and Exchange Commission

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

COUNTERSTATEMENT OF THE ISSUES PRESENTED

1. Whether there was substantial evidence to sustain the Commission's findings of willful violations of the antifraud, registration and other provisions of the federal securities laws when the record showed that (a) public investors were induced to place their trust and confidence in petitioners by false and misleading claims of petitioners' ability to provide individualized, comprehensive "financial planning"

services; (b) petitioners did not disclose to their customers that "financial planning" involved the systematic use of high pressure sales tactics to sell high-commission securities that would yield petitioners the greatest income; (c) petitioners made predictions and representations about speculative securities they offered and sold without having any basis for such claims; (d) petitioners offered and sold unregistered securities in unseasoned companies to persons having neither access to nor possession of the material information about such companies that registration would have disclosed; and (e) petitioners failed to comply with even the simplest recordkeeping, broker-dealer registration and operational requirements of applicable Commission rules.

2. Whether sweeping claims of agency prejudgment, lack of notice and the allegedly improper denial of a motion to reopen the record can be sustained when petitioners make absolutely no showing that they have been prejudiced and the record demonstrates that the Commission's final order was the culmination of a full and fair hearing during which evidence and argument bearing on the relevant issues of fact and law were thoroughly presented by the parties and considered by the Commission.

3. Whether the Commission acted within its discretion in determining that the mitigative factors put forward by petitioners were inadequate to overcome the overwhelming evidence of their

serious and repeated violations of the federal securities laws; that petitioners had proved themselves unfit for the public responsibilities entailed by members of the securities industry; and that, accordingly, the public interest would best be served by the imposition of remedial sanctions barring petitioners from the securities business.

* * * *

This case was previously before the Court on petitioners' motion for a stay pending review, which was denied by the Court on March 11, 1971.

COUNTERSTATEMENT OF THE CASE

Haight & Co., Inc., a broker-dealer (formerly known as Hodgdon & Co., Inc.), and eight officers and salesmen of the firm ^{1/} have petitioned this Court, pursuant to Section 25(a) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. 78y(a), to review an order of the Securities and Exchange Commission ("Commission") (JA 338) ^{2/} based upon findings that petitioners had committed a multitude of violations of the federal securities laws. ^{3/} The Commission's order, entered on February 19, 1971, at the conclusion of an administrative proceeding held pursuant to Sections 15(b), 15A and 19(a)(3) of the Exchange Act, 15 U.S.C. 78o(b), 78o-3 and 78s(a)(3), revoked the broker-dealer registration of Haight & Co. ("Registrant"), expelled Registrant from membership on the Philadelphia-

-
- 1/ A. Dana Hodgdon, president of Haight & Co. during the period in question; James F. Haight, vice-president in charge of sales and training and president, a director, and the major stockholder since July 1964; W. Lyle Carr, Jr., senior vice-president; David M. Adam, Jr., James W. Harper III, and Burton Kitain, assistant vice-presidents; Homer E. Davis and Robert F. Kibler, salesmen.
- 2/ "JA ____" refers to pages of the joint appendix to the briefs; "RA ____" refers to pages of respondent's appendix; "Op. ____" refers to the Commission's findings and opinion; "Tr. ____" refers to pages of the transcript of the proceeding before the Commission; "Ex. ____" refers to exhibits of the Commission's Division of Trading and Markets; "Px. ____" refers to exhibits of petitioners; "Br. ____" refers to pages of petitioners' brief; "I.D. ____" refers to pages of the Initial Decision of the Hearing Examiner. The preparation of Respondent's Appendix was necessitated by the refusal of petitioners' counsel to include in the Joint Appendix any of the record references designated by the Commission. Petitioners' counsel offered no reason for this flat refusal other than his own inconvenience and suggested that the Court could refer to the 29 volumes of the transcript if it wished to read the Commission's references. The Commission could not agree to subject the Court to such obvious inconvenience and accordingly reproduced its own appendix.
- 3/ This petition (No. 71-1136) has been consolidated with a petition of Haight & Co. and Haight seeking review of the Commission's order (JA 280-281) denying their motion for leave to reopen the record to adduce additional evidence with respect to appropriate sanctions (No. 23,244) and their application to this Court for leave to adduce such additional evidence (No. 23,246).

Baltimore-Washington Stock Exchange and in the National Association of Securities Dealers, Inc., and barred each of the individual petitioners from association with any broker or dealer.^{4/}

In its opinion, the Commission found that:

1. Petitioners willfully violated the antifraud provisions of the federal securities laws 5/ by (a) engaging in a scheme to defraud public investors, who were induced by petitioners, claiming to provide comprehensive "financial planning" services, to purchase securities that yielded petitioners the greatest income, and (b) making materially false and misleading statements to customers in connection with the offer and sale of certain securities.
2. Registrant, Hodgdon, Kitain, Carr and Davis willfully violated the registration provisions of Section 5(a) and (c) of the Securities Act of 1933, 15 U.S.C. 77e(a) and (c).
3. Registrant, aided and abetted by Hodgdon, Haight and Adam, willfully violated the recordkeeping provisions of Section 17(a) of the Exchange Act, 15 U.S.C. 78q(a), by falsely marking as "unsolicited" certain order tickets and confirmations.
4. Registrant, aided and abetted by Hodgdon, willfully violated Section 15(b) of the Exchange Act, 15 U.S.C. 78o(b), and Rule 15b3-1 thereunder, 17 CFR 240.15b3-1, by failing to amend its broker-dealer registration application to reflect the election of new officers and directors.
5. Registrant willfully violated Section 15(c)(2) of the Exchange Act, 15 U.S.C. 78o(c)(2), and Rule 15c2-4 thereunder,

^{4/} Louis S. Amann, a former vice-president and salesman of the firm, was similarly barred but did not file a petition for review. The Commission ordered that the proceedings against Harvey E. Baskin, a salesman and the remaining respondent below, be dismissed.

^{5/} Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), and Sections 10(b) and 15(c)(1) of the Exchange Act, 15 U.S.C. 78j(b) and 78o(c)(1), and Rules 10b-5 and 15c1-2 thereunder, 17 CFR 240.10b-5 and 240.15c1-2.

17 CFR 240.15c2-4, by failing promptly to transmit to an issuing company the proceeds of its distribution, for which Registrant was acting as underwriter.

Scheme to Defraud "Financial Planning" Clients

The Commission found (Op. 3-15, JA 312-324) that between May 1960 and June 1964 Registrant, together with or willfully aided and abetted by the individual petitioners, ^{6/} engaged in a scheme to defraud by purporting to offer comprehensive "financial planning" services without disclosing to customers the real purpose and effect of such "planning" — petitioners' personal enrichment. This scheme constituted a willful violation of Section 17(a) of the Securities Act and Sections 10(b) and 15(c)(1) of the Exchange Act and Rules 10b-5 and 15c1-2 thereunder. Petitioners held themselves out as financial planners who would independently exercise their assertedly highly developed talents to advise their customers; in fact, petitioners adhered to a preconceived plan that tended to ensure customers would purchase substantial amounts of securities yielding the highest income to petitioners. Registrant and its officers actively encouraged and engaged in high pressure tactics to obtain "financial planning" clients, and to get those clients to enter into securities transactions, particularly those involving securities whose purchase was highly remunerative to Registrant and its salesmen.

^{6/} As petitioners note (Br. 10), Registrant began as a sole proprietorship under Hodgdon in 1955, became a partnership in 1956 consisting of Hodgdon, his wife and Carr, and was incorporated as a broker-dealer in 1960, Hodgdon becoming president and treasurer, Carr senior vice-president, secretary and board member and Haight, who had joined the firm in 1958, vice-president in charge of sales and training.

Registrant placed great emphasis on the financial planning concept (Tr. 3732, JA 118), which it described in a widely-circulated sales brochure as a "financial blueprint for the future" and the means by which any investor could "commit his funds to equity investment as a strategy" and thereby avoid "excessive preoccupation with the short term" (Ex. 144, p. 3, RA 219). The firm conducted training sessions — largely through Haight, who was in charge of training and sales (Tr. 3735) — in which new salesmen were told how to obtain "financial planning clients" and were instructed in techniques for getting such clients to engage in securities transactions, including — but not limited to — transactions through which Registrant would realize larger sales commissions than are obtainable through the sale of listed securities. ^{8/}

Salesmen were instructed to "prospect" (Tr. 3738-40, RA 119-121) for financial planning "clients" (Tr. 3973-4, RA 143-144) by making at least 40 "cold" telephone calls a day, using lists of names from federal government telephone directories or elsewhere, and by conducting at least two interviews a day (Tr. 3739-40, 2047-9, RA 120-1, 52-4). Salesmen were instructed to tell prospects that "we at Hodgdon & Co. perform a unique investment service for our customers which we call financial planning" (Tr. 3758-64, RA 123-9), characterized by the salesmen as "a method of integrating many factors such as tax bracket, pension income,

^{8/} Registrant was not a member of the New York or American Stock Exchanges and therefore could not obtain executions on those exchanges at member rates.

inflation, retirement plans, children's education, social security benefits, and insurance needs into one over-all Financial program with specifically-defined goals" (Ex. 247, RA 225). The salesmen would explain to prospective customers that financial planning required that securities be purchased under a "ratio" system to help [the customer] meet his financial objectives" (Tr. 3759, RA 124), with about 50% of the clients' investments being placed in mutual fund shares, usually sold with a high sales charge, 30% in a middle category lumping "blue-chips" (i.e., listed securities) and real estate securities, and 20% in "special situations and speculations" (Tr. 3750, 4150, 6222, 9895, 11,863-4; Ex. 258, RA 230). The salesmen were to tell the prospect that financial planning involved the "use of many different tools" and that Registrant accordingly had "a wide range of investments to fit your needs" (Ex. 258, RA 230), including real estate syndications and new issues underwritten by Registrant. ^{9/}

Despite the fact that mutual fund, real estate and new issue sales by their nature yielded petitioners much higher commissions than did

^{9/} In their solicitation of financial planning clients the salesmen mailed a brochure, written by Hodgdon (Tr. 6222-3), which expanded upon the concept of financial planning (Tr. 2050). The brochure stated, among other things, that "the 'Haves' hold wealth in the form of insurance savings, Government bonds, and deposits in lending institutions," that "every dollar which seeks savings instead of intangibles is a dollar working in the wrong direction," and that financial planning "can help the 'Have-Nots' become the 'Haves'" (Ex. 143, 144, RA 218-9).

sales of other types of securities,^{10/} the salesmen were not instructed to reveal this fact, nor did Registrant's sales literature even hint at the fact that its "financial planning" scheme would result in particularly lucrative transactions for the firm and its salesmen (Ex. 143, 144, RA 218-219). Yet it is undisputed that high-commission^{11/} securities comprised a large percentage of the firm's recommendations. Of course, as petitioners point out (Br. 15), the final prospectuses of mutual funds, new issue companies and real estate syndications disclosed the sales charges and commissions involved. But these prospectuses did not — and could not — convey the critical disclosure that the "financial planning" concept promoted by petitioners contemplated purchases of securities which resulted in maximum transaction income to them, apart from any benefit which may have ensued to their unknowing customers.

If the "prospect" responded to the "cold call" — actually a canned presentation (Ex. 248, RA 226) — the salesman would then obtain every detail of the prospect's financial situation — income, securities

^{10/} As petitioners admit (Br. 14), mutual fund sales and new issues underwritten by the firm carried "much" higher sales commissions than securities listed on exchanges -- i.e., about 7% for mutual fund sales, 8% to 10% for new issues, as compared with 1-1/2% for listed securities. In addition, securities sold by the firm as principal or "market maker" were especially lucrative since the firm, as is customary, would mark down the price by 5% when it purchased the security for its own account and mark the price up by 5% when it sold the security. (Tr. 2175-7). For convenience we will refer to mutual fund shares, new issues and securities sold in principal transactions as "high-commission" securities.

^{11/} As petitioners concede (Br. 11) only 25% of Registrant's gross volume of securities transactions involved listed securities. A member of the New York Stock Exchange's Department of Member Firms spoke of Registrant as "certainly not the typical non-member firm" in that so much of its income came from underwritings and mutual fund sales (Ex. 457, p. 2, RA 236).

and real estate holdings, mortgages, insurance, tax bracket, age, occupation, dependents, social security, retirement plan, savings accounts, charitable contributions, trusts, possibility of inheritances, and whether the prospect had a will (Tr. 3764-65, Ex. 16, RA 129-30, 214). It was most important to determine "what are his [the prospect's] dreams, where is he going," since this, according to one of Carr's sales lectures, "will be key in enabling us to sell him" (Ex. 259, RA 231). On the basis of this information the salesman would then devise a written financial plan listing financial goals, setting up investment ratios purportedly designed to reach such goals, and making specific recommendations for immediate action (Tr. 2061; Ex. 73, RA 61, 216). In short, the customer was encouraged to place his financial future in the hands of petitioners, to rely upon them as trusted confidants and advisers.

Specific Tactics for Obtaining Financial Planning Clients and Selling Securities

Haight instructed new salesmen that in soliciting financial clients they should "appeal to fear, appeal to greed, appeal to fear of inflation, appeal to fear of loss . . ." (Tr. 4178-4188; Ex. 258, 260, RA 146-56, 230, 232). As an example of an appeal to fear, salesmen were to point out such grim "statistics" as "54 men out of every 100 are living off friends, relatives and charity" and "50% of all Connecticut doctors who died in the last 10 years died bankrupt" (Tr. 11,855, RA 199). No attempt was made to demonstrate the relevance of these supposedly unsettling "facts" to a rational program of investment. Customers were to be dehumanized into a state of Pavlovian reaction if at all possible.

Haight also taught techniques to be used in making sales presentations (Tr. 3779). He told the salesmen to "only give the facts that are of interest to the particular prospect . . . never give all the facts . . ." (Tr. 3782-3, RA 132-3); to overcome customers' objections by using the objections to make a sale (Tr. 3780, RA 131); to "dominate the interview" (Tr. 3781, RA 132); and to create a "sense of urgency" by saying: "You had better buy it before it goes up" (Ex. 290, RA 233).

Carr also instructed the salesmen in sales practices. Echoing Hodgdon's admonition to the salesmen that "not enough attention is paid to the subconscious mind of client or prospect" (Ex. 255, RA 229). Carr taught that in selling, emotion is more important than logic and that salesmen should "Hit on [the] Hot Button" (Ex. 245, RA 224) — which he defined as the objective "dearest to [a client's] heart" (Tr. 10,089) — and that "an ounce of enthusiasm at the proper time is worth a pound of knowledge" (Tr. 2112, RA 68). Carr also taught salesmen to respond to a client's request to cancel an order by saying: "What, cancel! You should have doubled your order" (Tr. 2111, 3811; Ex. 245, RA 224). Carr supplied the salesmen with no less than 14 ways "to convince someone to sell a particular security" (Tr. 3788-92, 2114-5, RA 70-1, 134-8).

The firm's insurance "specialist" lectured on still other techniques for freeing up funds for securities purchases. Customers were urged to borrow on the cash value of their life insurance policies or to switch from straight life to term insurance (Tr. 2091-4, 8809-10, Ex. 251, RA 63-6, 189-90, 227).

In one of his lectures the "specialist" told the salesmen: "Get [the client's] cash first, then go after insurance; our only purpose in discussing insurance is to free more monies" (Ex. 251, RA 227).

No disclosure was made to customers regarding the investment philosophy stressing appeals to fear and greed pursuant to which their trust and confidence were sought by petitioners.

Emphasis Upon High-Commission Sales

Prior to the relevant period, Registrant emphasized in its sales brochures that since it carried no inventory of securities and did not participate in underwritings--both of which activities yield greater profits to a broker-dealer firm and its salesmen than do ordinary agency transactions^{12/} — its "relationship with clients will be one of trust" (Ex. 111). Beginning in 1959, however, this policy was abandoned (Tr. 7805) and the firm

^{12/} See n. 10, supra.

began using various methods to require or induce salesmen to sell underwritten offerings, inventoried stocks and mutual fund shares carrying substantial sales charges. Under the new policy, each salesman who had been with the firm for over a year was required either to sell \$18,000 in mutual funds or other securities, or five mutual fund contractual plans in each two-month period, or to earn commissions netting him \$600 per month from sales of securities designated as "high quality" by Registrant (Tr. 12,257; Px. 13B, RA 210, 246). The term "high quality" securities included high-commission real-estate securities and mutual fund shares (Tr. 12,257-8, RA 210-11). Failure to fill these quotas was ground for and did occasion dismissal (Tr. 12,257; Px. 13B, RA 210, 246).^{13/}

In addition, salesmen were issued lists of "preferred" mutual funds, all of which gave Registrant reciprocal business^{14/} (Tr. 2217-18, RA 78-79, Tr. 12,502-3). Registrant paid bonuses semiannually for sales of \$30,000 or more of the shares of these preferred funds (Ex. 147, RA 219d).^{15/} The fund that was most stressed, and most

^{13/} The salesmen's income from Registrant consisted solely of the commissions they earned (Tr. 11, 234).

^{14/} During the period in question it was possible for a mutual fund to reward broker-dealers selling shares by directing that a portion of the commissions on the fund's portfolio transactions be paid to such broker-dealers.

^{15/} Petitioners argue (Br. 12) that the preferred list was necessitated by the record-keeping problems arising from the servicing of purchases from among the hundreds of available mutual funds, and that the bonus system merely ensured concentration in the preferred funds. Registrant's customers would doubtless have been interested in knowing that Registrant limited its recommendations to only 20 mutual funds because of back office problems, but they were never informed of this fact. E.g., Carr admitted in his testimony (Tr. 9895, RA 191) that he told clients: "We handle practically all the mutual funds."

recommended and sold, was Aberdeen Fund of whose distributor Hodgdon was a director and stockholder until some time in 1963 (Tr. 3409, 3895-7, 6295, 6320, 6371, 7681-2, 10,103-4; Ex. 256, 258). Customers were not advised of these quotas, nor were they specifically told of Hodgdon's affiliation with Aberdeen Fund.

Whenever the firm engaged in an underwriting, salesmen were asked to indicate the amount of the issue they thought they could sell (Tr. 2249, 4272-3, 6375-6, 6396, 11,410-11). One salesman testified that when he failed to dispose of the indicated quantity Haight "became excited, jumped from his seat, and told me that the firm had never — had never not sold anything it had undertaken to sell . . ." (Tr. 2178-9, RA 76-77).^{16/} Another example of the firm's stress on high pressure in the sale of securities is contained in the testimony of another salesman who stated that, in connection with one of the firm's underwritings, Carr told the sales staff to "find the easiest money first, such as savings and loan money [and the] cash value of life insurance policies" (Tr. 3827-8, RA 140-1).

With respect to securities in which Registrant had a position — i.e., inventoried securities — salesmen were given, at the compulsory weekly staff meetings (Tr. 4074, 4088, 6321-2), a list of such securities, the number of shares they were supposed to sell, and the commissions for

^{16/} Another salesman, who did not want to sell one of the firm's underwritings because he considered it "an extremely high risk," testified that Hodgdon told him that "my cooperation on the underwriting was vital to the interests of the firm and that he expected me to do my part in the underwriting" (Tr. 31, RA 1). About a week after this conversation, Hodgdon talked to the salesman about the latter's lack of enthusiasm for certain of the firm's underwritings and closed the discussion by asking for the salesman's immediate resignation (Tr. 31-33, RA 1-3).

selling them (Tr. 2258-61, 3414-17, 3953, 6369-70, 6391-2, 7087-90; Ex. 153, 458, 550-2). Hodgdon admitted in his testimony that if the firm's position in a security became larger than desirable, the salesman's commission would be increased (Tr. 7821-2, RA 131-2). Carr urged the salesman that in selling inventoried securities to financial planning clients they should "go into an area where we have something to sell. If not, try to sell [the client] what is easiest" (Tr. 3780, 4179-88, RA 132, 147-56, 228, Tr. 11,851-65).

Registrant's policy of stressing high-commission stocks was, in fact, explicitly acknowledged within the firm. A January 1961 memorandum from Haight and Carr to the other officers of the firm recommended that salesman be told occasionally about "blue chip" securities so that in "initial" conversations with prospects the salesman could "discuss" them to show that the firm did not deal only in high-commission situations (Ex. 447, RA 235). Carr, himself, admitted in his testimony (Tr. 9895, RA 191) that in discussions with clients he would say: "We handle stocks on all the Exchanges . . ."^{17/}

No disclosure was made to customers of these sales techniques and the role they played in petitioners' "financial planning" scheme.

Registrant's Advertising

Advertisements extolling various aspects of Registrant's operations were broadcast at least once each day over a local radio

^{17/} Apart from high-commission real estate securities, the firm only "occasionally" recommended common stocks, most of which were stocks in its inventory (Tr. 6372, RA 170). One salesman testified "I don't remember ever having received any written instructions on the recommendation of any listed securities" (Tr. 3416-7, RA 116-7).

18/
station. The advertisements stressed:

- (1) The asserted experience and special expertise of the firm's salesmen:

"[W]hen you drop into one of Hodgdon & Co.'s offices . . . you'll be welcomed by a counselor who is an expert in financial planning in the field of securities--profit sharing--insurance reviews--and oil programs" (Ex. 556, RA 238).

"Call in an investment expert, one of the many informed specialists at Hodgdon and Company" (Ex. 554, RA 238).

"Trained investment analysts will go over your present portfolio . . . such advice is based on Hodgdon & Co.'s own vast experience in the financial field . . ." (Ex. 575, RA 243).

- (2) Hodgdon & Co.'s asserted research capabilities:

"Hodgdon and Company has no crystal ball but they do have a research staff that has thoroughly and competently analyzed the probable course of the market . . ." (Ex. 573-4, RA 241-2).

- (3) The firm's asserted interest in established companies:

"Advice on individual stocks is freely given based on Hodgdon's vast experience in the financial field" (Ex. 616, RA 245).

"Registered representatives at Hodgdon are always alert for new opportunities for investment while never forgetting long-established stocks, bonds, mutual funds and the like. In short, a balance is maintained between the new, and the tried-and-true" (Ex. 615, RA 244).

- (4) The firm's special interest in inexperienced investors:

"Hodgdon & Co. would like to issue a special invitation to new investors Well, let me promise you this--when you talk with a Hodgdon & Company representative about investments your eyes will really be opened to a fascinating field of financial opportunities" (Ex. 557, RA 240).

18/ The advertisements were prepared by public relations counsel with Hodgdon's assistance (Tr. 12,239, 12,417). Although, as petitioners point out (Br. 15-16), the particular advertisement referred to by the Commission was marked "Don't Use," except for the phrase "long range gain, immediate gain" the same advertisement was used as well as other advertisements noted below.

In fact, however, Registrant's "trained investment analysts" were, as Hodgdon admitted, for the most part recently-hired salesmen who had little or no previous experience in the securities business (Ex. 457, p. 41, RA 237); the firm simply had no research staff (Tr. 2168, 7820-21, RA 72, 180-1); and the firm largely ignored "well-established stocks and bonds" in favor of those purchase recommendations that would be most lucrative for the firm (Tr. 3416-7, 6369-72, Ex. 447, RA 116-7, 167-70, 235). Registrant's quest for "new investors" was, of course, in pursuance of its scheme to gain the confidence of those unsophisticated persons who would most likely succumb to the touted attractions of "financial planning."

Transactions with Financial Planning Clients

As found by the Commission, the overall scheme to defraud financial planning clients involved not only high pressure sales tactics and deceptive advertising but also specific dealings with financial planning clients, in which the individual petitioners implemented the fraudulent techniques described above (Op. 7, JA 316). The Commission concluded (Op. 14, JA 323) that in these dealings the individual petitioners induced customers, many of whom were inexperienced and unsophisticated,

"to believe that their best interests would be served by following the investment program designed for them by [petitioners] In fact, such programs were designed to sell securities that would provide the greatest gain to [petitioners], rather than to promote the customers' interests; indeed, in some instances, the recommendations were directly contrary to the

customers' expressed investment needs and objectives. Moreover, various representations were made to clients to lull them into a feeling of security or to believe that their complaints were unjustified, and thereby sustain their confidence for further recommendations."

The Commission's purpose in setting forth these transactions with clients was not, of course, to draw any nice statistical calculation of the impact of petitioners' fraudulent scheme on their many thousands of customers. Nor were the Commission's findings intended to sustain any claim that particular customers suffered specific losses or were induced to purchase securities unsuitable for acquisition by them (Op. 15, JA 324). Rather, the instances described provide concrete proof that petitioners not only devised a scheme to defraud "financial planning" clients, but actively put that scheme into operation by making recommendations and sales pitches without disclosing the underlying philosophy and modus operandi upon which the financial planning concept turned. That this fraudulent course of conduct, in contravention of even the lowest standards of professional honor and principles, was willfully inflicted on any of petitioners' customers clearly shocked the Commission's conscience.

1. Adam

Adam, who joined Hodgdon & Co. as a salesman in 1960, became a "group manager" in 1962, supervising about five salesmen, and in 1963 was appointed an assistant vice-president (Tr. 8108-9, 8122-3,

8349, 8386-87, 8371). Dr. G became a financial planning client of Adam in August 1960. In December 1960, at Adam's request, Dr. G gave him discretionary authority over her account (Tr. 1047-9; Ex. 74, 89), because, according to Adam, she had a "complete lack of knowledge of investments and Financial Planning" (Ex. 688).

In January 1963 and March 1964, Adam sent Dr. G written analyses of her account (Ex. 79, 82). Although the 1963 report showed a net loss on purchases effected up to that time of about \$200, Adam nevertheless wrote: "[Y]ou must be congratulated on the overall performance to date; and as we continue to work together over the years, we are planning to double the amount of invested capital" (Ex. 79, RA 217). The 1964 report showed a profit of about \$7,000 and, in an accompanying letter (Ex. 84), Adam wrote: "[D]uring the next five-ten years your net worth could easily amount to \$120,000 minimum rather than the present \$75,000. Let's keep it up." Both reports omitted any comment on Dr. G's total loss in 1962 of her \$11,000 investment in a speculative security purchased at Adam's suggestion (Tr. 1056-7; Ex. 75-77).

Adam caused Dr. G to sell her entire portfolio of listed securities--worth about \$30,000--and cash in her annuity of \$40,000, and to purchase other securities with the proceeds (Ex. 73, 423-424). Her total purchases consisted of about \$30,000 in Aberdeen Fund and

another mutual fund, \$12,500 in highly speculative gas and oil programs, and about \$50,000 in other securities,^{19/} almost all of which were new issues that Registrant was underwriting or for which it was acting as a member of the selling group and stocks which Registrant sold as principal at a mark-up (Ex. 423-424). Adam did not disclose to Dr. G that the bulk of these recommended purchases resulted in high commissions and sales charges, in conformity with Registrant's "financial planning" scheme (Tr. 1,083).

Capt. S, who had a portfolio of individual securities valued at \$45,567, in addition to shares in two mutual funds (Ex. 200), sold, pursuant to Adam's advice (Tr. 2798, 2772-3), all but about \$1,600 worth of his original portfolio (aside from the mutual funds shares) to buy other securities recommended by Adam. Also pursuant to Adam's suggestions, Capt. S cashed in two life insurance policies to buy into one of the firm's real estate syndications and obtained three bank loans totalling \$12,400 to finance other securities purchases (Ex. 205, 206, 527; Tr. 2682-3, 8287-9, 8530-3, 2681-2, 8306-7, 8550-1). Thus, of a total of about \$71,000 in securities purchased on Adam's recommendations, \$61,000 represented securities sold by Registrant as underwriter or principal (Ex. 528, 529). In November 1961,

^{19/} These figures represent total purchases, including purchases paid for with proceeds of the sale of other securities purchased during the period. This is also the case with respect to the purchases in a number of other customer accounts described below.

Capt. S purchased additional shares of a speculative security, on Adam's recommendation that he should average down his cost per share. Adam represented that he had received word that the stock "was still a good buy" (Tr. 2662; Ex. 528). On the same day, however, Adam had recommended that Dr. G sell the same security, in part because of adverse information he had received concerning the company (Tr. 8511-13, 8462-4, RA 183-8).

In September 1962, Adam sent Capt. S a written progress report which, although it showed losses in every category of investment except in the two mutual funds in his original portfolio, nevertheless contained Adam's note of praise: "[Y]ou must be complimented on your successful accumulation of wealth over the years. This success places you within the top four percent of all individuals in the country" (Ex. 204, RA 223). The basis for this statistical conclusion and its relevance to Adam's investment recommendations were not disclosed, nor were the elements of Registrant's "financial planning" scheme stressing high commission sales explained to Capt. S. The "progress report" closed with Adam's comment that "our overall performance must continue to be outstanding for you" (Ex. 204, RA 223), although no basis
20 /
was given for this assurance.

20 / Petitioners' attempt to justify their conduct (e.g., Br. 23) on the basis of facts showing that they purchased for themselves and their relatives securities also recommended to financial planning clients is without relevance since the Commission's findings do not depend on petitioners' beliefs as to the merits of particular securities recommended.

2. Harper

Harper joined Registrant as a salesman about the end of 1960 (Tr. 6751-2), his only previous experience in the securities business being the few months he spent as a trainee with another firm (Px. 7t). He was designated a "specialist" in the gas and oil programs offered by the firm to investors--although he had not previously worked in this area (Tr. 6820, Px. 7t)--and lectured new trainees in that area (Tr. 5997-6001, 6363). He was appointed an assistant vice-president in 1963 (Tr. 6234, 6754).

Mrs. D, a divorcee with a dependent son, had a portfolio of seasoned high quality stocks and bonds worth about \$200,000, which she had acquired through inheritance and gifts (Tr. 2285-6; Ex. 155, 427). She told Harper that she would like to increase the income from her portfolio but that any changes were to be in "safe things, well-seasoned stocks" since she needed security (Tr. 2413-14). ^{21/}

As Harper was aware, Mrs. D was a wholly unsophisticated investor (Tr. 2284, 2292). He told her that Registrant specialized in "estate planning," and that she need not be concerned about investing since she would have "expert advice" (Tr. 2284, RA 81). Mrs. D. agreed to Harper's suggestion that a radical change be made in her

^{21/} Her yearly income consisted of about \$7,500 from her securities and \$2,400 in alimony which she told Harper she was fearful of losing and which she needed "to sustain herself" (Tr. 2285-6, 6891-2).

portfolio, but stated that she "had to play it very safe and be very conservative." Harper assured her that she was not to worry, that he would do the worrying for her (Tr. 2292-5; Ex. 156, RA 90-3, 220). Shortly thereafter, Harper wrote to Mrs. D, in answer to a letter in which she again expressed her fears and concern for investment safety (Ex. 156). He stated: "I must stress to you that . . . you are playing it safe. . . . We are now keeping you comfortable and moving you towards the \$500,000-\$750,000 level. . . . You are 50% better off today than you were [six days earlier]. . . . G. M. & Merck could now collapse and you would not be hurt" (Ex. 157, RA 221).

Mrs. D, upon Harper's recommendations, sold more than \$122,000 worth of securities from her original portfolio. On his advice she effected purchases of \$20,000 of Aberdeen Fund, \$2,200 in another mutual fund, about \$14,600 in a gas and oil program, and about \$87,000 in other securities, more than \$82,000 of which Registrant sold as underwriter, selling group member or principal (Ex. 484). Of the latter amount, about \$69,000 was placed in new issues (which the firm was underwriting or for which it was acting as selling group member), notwithstanding Mrs. D's pleas for well-seasoned and safe investments (Ex. 427-9; Ex. 484). No disclosure was made to Mrs. D of Registrant's preconceived scheme stressing high-commission securities.

Mrs. M, an inexperienced investor whose goal was retirement income, testified that Harper told her "that I should consider him like my doctor, that he would then be able to kind of diagnose my financial potentials and possibilities" (Tr. 1860, RA 45). She testified further: "I reacted to this with confidence. They, after all, are experts in financial counselling" (Tr. 1860, RA 45). She also testified that she relied on Harper and usually followed his recommendations (Tr. 1889-90, RA 48-9). ^{22/} Although Mrs. M stressed her desire for liquidity, Harper recommended and sold to her limited partnership interests in various real estate syndications that Registrant was underwriting, assuring her that, in the event of an emergency, she could get her money out in a relatively short time (Tr. 1870, 1876, RA 45-1 to 45-2). However, it was not explained to her that the firm only maintained "work-out" markets in such securities so that an investor could not necessarily dispose of them readily unless there were a buyer available. When some of the syndications ran into difficulties Registrant was in fact unable to find buyers for all those who wished to sell (Tr. 1861, 1866, 1876, 1927-8, 6935-6, 7141, 7163-4, 13,319-20, 13,345 et seq.). After the cash distributions were cut on two of the syndications purchased by Mrs. M, Harper repeatedly dissuaded her from attempting to dispose of them (Tr. 1901-2, 1905-6).

^{22/} Her trust and confidence in Harper was such that she even sought his advice as to whether she should invest in her husband's business (Tr. 1899), which he advised her not to do (Tr. 1900).

Harper called Mrs. M several times before persuading her to buy another security, about which she felt "very insecure," representing to her that she could "probably double [her] money on it within two or three years" (Tr. 1880-81, RA 46-7). No basis for this prediction was given.

Of Mrs. M's total purchases through Harper of about \$27,000, mutual fund shares accounted for about \$2,500 of this amount and all but \$1,140 of the balance represented new issues that Registrant was underwriting and securities sold by the firm as principal (Ex. 483, 484). No disclosure was made to Mrs. M regarding Registrant's scheme to emphasize sales of high-commission securities.

In his written progress reports to Dr. B, Harper placed Dr. B's investments in the firm's real estate syndications in the "high grade" category along with the client's mutual fund holdings. In one such report, Harper even placed a gas and oil program that he had sold Dr. B into that category (Ex. 373, 382, 383, 470). On Harper's recommendations, Dr. B sold securities initially held by him for about \$19,000, and thereafter effected purchases of about \$26,000 in gas and oil programs, \$11,000 in mutual funds and \$73,000 in other securities, of which latter amount about \$50,000 represented securities underwritten by the firm or sold as principal (Ex. 505, 506). No disclosures were made as to Registrant's systematic emphasis on high-commission securities transactions.

3. Kitain

Kitain joined Registrant in 1959 and received the usual training for new salesmen (Tr. 10,709, 10,718-720, 10,737-9). In September 1960 he was appointed manager of the new suburban branch office, and in 1963 became an assistant vice-president (Tr. 10,664, 10,837).

Mrs. Y had a diversified portfolio of high grade stocks and bonds valued at between \$90,000 and \$100,000 (Tr. 2489-91; Ex. 177). She felt that her portfolio was not being given enough attention, and wanted "closer consultation" with a knowledgeable adviser since she herself was "ill informed" as to investments (Tr. 2494, 2548). Kitain told her that many of her stocks "were of doubtful quality," and that she should sell the bulk of them and divide \$50,000 of the proceeds equally between Aberdeen Fund and another mutual fund which were assertedly more growth oriented (Tr. 2493-4, RA 104-5, Tr. 11,099-11,101, 11,500). In partial fulfillment of Kitain's plan, Mrs. Y sold more than \$30,000 of her portfolio and invested \$30,000 in the two mutual funds. Kitain — like the other petitioners — did not explain that mutual fund purchases entailed commission costs substantially higher than those charged on the purchase of listed securities.

Mr. R was a foreign service officer, married and with three small children, a salary of \$10,000, a mortgaged home, \$4,500 in cash and government bonds and small holdings of three listed securities (Tr. 260-3; Ex. 16). He told Kitain that his objectives were to provide for the college education of his children and to supplement his retirement income (Tr. 257), and that "generally speaking" he wished to continue buying safe growth stocks (Tr. 259-60, 273, 10,789). However, Kitain discouraged Mr. R from purchasing listed securities, telling him that if he bought Aberdeen Fund and another mutual fund he would "in effect" participate in blue chip stocks "in a much more efficient and probably a more meaningful way" (Tr. 11,442-3; Ex. 744, RA 192-3, 246).

Despite Mr. R's modest finances, Kitain did not explain that this form of "participation" involved substantial sales charges that were five times higher than those on the purchase of the underlying securities held by the mutual funds. Kitain told Mr. R that he could afford to speculate, and even suggested that it would be possible to convert life insurance policies to lower cost term insurance, which would free capital to invest in speculative situations. Mr. R in fact converted some of his policies and borrowed on others, investing at least part of the proceeds in securities, including two of a speculative nature recommended by

Kitain (Tr. 258-9, 269-70, 323-4, 11,422-2; Ex. 742). Kitain also advised Mr. R to borrow money to make securities purchases and, in fact, introduced him to the same bank manager to whom he had introduced Mrs. Y. Mr. R effected loans through that bank for the purpose of making securities purchases (Tr. 270-1, 329-30, 10,963-5).

Prior to purchasing \$15,000 worth of Aberdeen Fund pursuant to Kitain's recommendation, Mrs. A, who had a very limited knowledge of securities (Tr. 788), complained that withdrawal of that amount from her savings and loan account would result in a yearly loss of \$600 in interest. Kitain advised that she could receive this amount by making regular withdrawals from her Aberdeen account which he asserted would be covered by the fund's "interest" payments (Tr. 793, RA 9). Mrs. A then made the purchase. However, after three withdrawals she discovered that she was using up her principal and stopped withdrawal of any further sums (Tr. 791-3, 11,041-3, 11,456-63).

When the price of a stock Mrs. A had purchased through Kitain continued to drop she asked Kitain what was wrong and he replied that Registrant wanted the stock to go down so that all of its customers could be "put into the security" (Tr. 798-99, RA 10-11, Tr. 11,070-73).

Of the \$34,500 worth of securities in addition to Aberdeen Fund that Mrs. A purchased through Kitain, all but about \$6,000 represented new issues sold by Registrant as underwriter or selling group member or securities that it sold as principal (Ex. 523, 524).

4. Davis

Davis had no experience in the securities business prior to the time he joined the firm as a salesman in 1957 (Tr. 5664-5665). Mr. and Mrs. M were inexperienced investors (Tr. 1503) desiring to "build a good financial future" for themselves (Tr. 1499). Davis elaborated on Registrant's concept of financial planning, telling them that they "would have to have complete confidence in him [and] confide in him totally" (Tr. 1502, RA 27, 10,393), and assuring them that with his assertedly "expert" help and that of Registrant's staff of "experts," the proper type of investments would be made for them (Tr. 1503, RA 28).

Davis recommended mutual funds and also told the M's that they could afford to buy speculative issues, stating that he did not know of anyone who ever got rich on blue chips because such stocks just varied a few points, and that the speculations he recommended would be "the blue chips of tomorrow" (Tr. 1523-24, RA 29-30). No basis for this assertion was given.

Mrs. M testified that, in recommending investments, Davis always told them that they would make great profits, generally within a specified time (Tr. 1532, RA 31). Davis stated, for example, that one speculative security would double in value in about two years (Tr. 1532, RA 31) and that another security being issued at \$4 would rise 1 to 3 points (Tr. 1588-9, RA 32-33). He did not suggest any basis for these predictions. As is frequently the case in sales of newly issued securities, the M's ordinarily did not receive a prospectus

on new issues they purchased until they got their confirmations. They thus relied on Davis' recommendations. When Mr. M insisted on seeing a particular prospectus before purchasing a speculative issue underwritten by Registrant which Davis was recommending, Van-Pak, Davis reluctantly agreed, stating: "I will send it, but don't pay attention to it. It will not reflect what the situation truly is." When Mr. M. read the prospectus and told Davis that the stock looked "dreadful," Davis replied: "Just . . . ignore [it], any prospectus just looks terrible . . . certain regulations are required as to what you can put in a prospectus and it always paints a very bleak picture." He asserted that if people based their investment decisions on prospectuses "no one would ever put a cent into anything" (Tr. 1592, 1597, 1701, 1749-53, RA 35-44). Davis did not pinpoint any inaccuracies in the prospectus or indicate the source of his optimistic projections.

Davis and the firm's insurance "specialist" also advised the M's to cash in their life insurance and purchase lower cost term insurance, in order to free funds for securities purchases, telling them that they would be notified when, with proper investments, they had become "self-insured," at which point they could cancel their term insurance as well. (Tr. 1500-1, 1677, RA 25-6, 37), Tr. 10,595-9). The M's followed the advice, investing the proceeds (obtained by surrendering their original policies) in securities that Davis recommended (Tr. 1500-1, 1677, 10,595-9). Again acting on Davis' advice, they borrowed \$5,200 for investment in the firm's real estate syndications and abandoned their original intention

of buying a farm after Davis told them that they were better off investing in things that "would be making them money" (Tr. 1520, 1680-1). Of about \$22,574 of securities purchased by the M's at Davis' recommendation all but \$436 represented new issues of which Registrant was the underwriter or securities that it sold as principal (Tr. 1630, 1766; Ex. 537-8). No disclosures were made concerning Registrant's predetermined emphasis on high-commission securities.

Davis had discretionary authority with respect to the account of Cdr. C, a naval aviator stationed overseas (Tr. 542-5; Ex. 40). Of total purchases of \$14,981 in Cdr. C's account, \$13,256 represented new issues of which Registrant was underwriter or securities it sold as principal (Ex. 488-9). Although Cdr. C was admittedly desirous of speculating, he was not advised of Registrant's policy stressing speculative securities whose sale would result in the highest commissions for petitioners.^{23/}

5. Kibler

Kibler had no experience in the securities industry prior to joining the firm as a salesman in 1960 (Tr. 8880, 9053-9058). Mrs. S, an elderly widow with a portfolio consisting largely of seasoned, listed securities having a value of about \$50,000 (Tr. 4433; Px. 14s), told Kibler she wanted greater income and safety (Tr. 4434, 4436, 9154).

^{23/} While Davis may have purchased these securities for himself or his mother, he of course was completely aware of the facts surrounding these securities, including the benefits to Registrant and himself from their sale. His customers were not.

Acting on his advice, she sold more than half of her portfolio and invested about \$12,500 in mutual fund shares and \$19,500 in other securities, of which all but one small purchase were new issues underwritten by Registrant and securities that it sold as principal (Ex. 495, 496). Although Mrs. S may have realized some gains, she dealt with Registrant and Kibler without knowledge of their emphasis on high-commission business.

Dr. J, a 46-year-old federally-employed veterinarian, had a portfolio consisting of \$7,000 invested in government bonds and about \$18,000 in high-grade securities (Tr. 4749, 4752, 4756-7, 4768; Ex. 345). The "financial plan" that Kibler prepared for him specified a "minimum financial goal" of \$87,000 to be accumulated by age 65, and safety as one objective (Ex. 346). The plan recommended, among other things, that the government bonds be sold and that Dr. J's life insurance policies be converted to decreasing term insurance "to increase death protection coverage during period of growth of investment growth program." Kibler told Dr. J that the firm's real estate syndications which he recommended would be "easily marketable" (Tr. 4757, 4770-72, RA 158-61) and that the SEC required that prospectuses "not be particularly glowing," with the result that a prospectus would usually "play down the future or well being" of the company whose securities are being offered (Tr. 4754, RA 157). Kibler did not specify any inaccuracies in prospectuses. On Kibler's advice, Dr. J sold his government bonds and about \$10,000 worth of his other securities, reinvesting the proceeds in Kibler's recommended securities (Tr. 4746-7; Ex. 345, 513). From May 1962, when he opened his account, until February 1964, Dr. J purchased about

\$25,000 worth of securities all of which were mutual funds, new issues that Registrant was underwriting or stocks sold by it as principal. Kibler made some recommendations as to listed securities, but did not disclose Registrant's preconceived plan to stress high-commission business.

6. Hodgdon

As previously noted, Hodgdon was the founder of Registrant and one of the central forces in its "financial planning" scheme.

Mrs. W,^{24/} an inexperienced investor, acting on Hodgdon's recommendation, sold about \$32,000 worth of municipal bonds and purchased \$35,000 worth of other securities, of which \$30,000 was invested in two speculative new issues that the firm was underwriting, and the remainder in stocks that the firm sold as principal (Tr. 1226-7; Ex. 649). Mrs. W was not advised of Registrant's emphasis on high-commission securities.

7. Haight

Haight was vice-president in charge of sales and training, with broad responsibilities for Registrant's "financial planning" operations.

Miss T, an elderly woman with a high grade diversified securities portfolio worth about \$62,000 told Haight that she wanted increased income for her impending retirement (Tr. 4475-6; Ex. 324).

^{24/} Contrary to Petitioners assertion (Br. 33, n. 23) the Examiner did find that Mrs. W was a financial planning client (I.D. 68, JA 198), and the record supports this finding (Tr. 1227, 1236).

She sold about \$28,000 worth of securities from her original portfolio (Ex. 499) and, on Haight's recommendation, invested \$17,000 in Aberdeen Fund and another mutual fund, and about \$55,000 in other securities, virtually all of which represented real estate and other new issues being underwritten by the firm and securities it sold as principal (Ex. 500, 501). No disclosure was made to Miss T regarding Registrant's systematic emphasis on high-commission securities.

Miss B, also an elderly woman, with a portfolio of high-grade securities worth \$120,500, sold \$52,000 worth of that portfolio and, on Haight's recommendation, invested \$10,000 in Aberdeen Fund and about \$64,000 in other securities, more than \$58,000 of which represented new issues underwritten by Registrant or sold by it as principal (Ex. 491-2). Haight did not disclose to Miss B the elements of the financial planning scheme stressing high-commission securities sales.

8. Carr

Carr was an early and key figure in Registrant's operational history, serving as senior vice-president. Like Hodgdon and Haight, he was a principal exponent and teacher of the "financial planning" scheme.

In 1961, Colonel F, who was stationed overseas and had limited means, gave Carr discretionary authority over his financial

planning account (Tr. 4401-2). All of the ten stocks in his portfolio were sold for about \$7,800 and replaced with securities selected by Carr which, except for one minor purchase, consisted of Aberdeen Fund shares and five new issues underwritten by Registrant (Tr. 4402; Ex. 308, 310, 315, 509). Carr also suggested that the client borrow on his life insurance to make an investment in a real estate syndication, but this advice was not followed (Tr. 4412-13). Although Colonel F was interested in new issues, he was not advised that Registrant's systematic policy was to stress securities yielding the highest commissions for petitioners.

On Carr's recommendations General A sold certain stocks and invested \$2,500 in Aberdeen Fund and more than \$33,000 in other securities consisting of new issues underwritten by Registrant and stocks which it sold as principal (Tr. 4930-1, 4937-8, 10,183-4; Ex. 517-19). Like Colonel F, General A was interested in speculation, but received no disclosures as to Registrant's high-commission business orientation.

* * *

It should be observed that while each of the individual petitioners spared few flamboyant assurances and promises of impending financial security--even when these appeared peculiarly inappropriate--no effort was made to disclose fully and fairly to financial planning clients that petitioners' assurances and promises were an

integral part of their carefully preconceived and executed sales techniques and that recommendations as to the purchase or sale of securities--and even as to the disposition of other financial assets such as life insurance and personal savings--were inexorably tied to sales quotas and to petitioners' perpetual search for self-enrichment through high-commission securities sales.

Fraudulent Representations in the Offer and Sale of Securities

Wholly apart from petitioners' scheme to defraud public investors through the purveyance of "financial planning" services falsely purporting to provide comprehensive, unbiased, individualized investment counselling, the Commission found that in five separate cases various of the petitioners made materially false and misleading statements respecting securities they were offering for sale. These cases demonstrate that the "lessons" learned at training sessions that were designed to attract and maintain the allegiance of trusting customers were only the "First Grade" in Registrant's "School of Fraud." Having acquired some degree of skill in soliciting the confidence of investors, petitioners proceeded to offer and sell to those investors specific securities in willful violation of the antifraud prohibitions of the federal securities laws.

1. Van-Pak, Inc.

The Commission found that Registrant, together with or aided and abetted by Hodgdon, Haight, Carr, Harper, Kitain, Davis and Kibler, violated the antifraud provisions in connection with a public

offering of Van-Pak stock through Registrant as underwriter (Op. 15-17, RA 324-6). Van-Pak was a freight forwarder of individuals' household goods by the "containerization" method, primarily to and from overseas military posts (Ex. 52). Despite the fact that Van-Pak's prospectus explicitly stated that "containerization is not new in the transportation industry" and that Van-Pak "did not originate the containerized transportation method" (Ex. 52, RA 215), Hodgdon (Tr. 1227-a, RA 15), Carr (Tr. 1441, 1446, RA 19, 21), Harper (Tr. 1875-6), Davis (Tr. 1476-7, 1590, RA 23-4, 34) and Kibler (Tr. 1156-7, RA 13-14) all represented to customers that Van-Pak's moving methods were new.^{25/} The State of Virginia prohibited sales of Van-Pak stock in that state because it found the company to be insolvent (Ex. 298, 299). Haight (Tr. 2962, 2987, RA 107-8), Carr (Tr. 3016, 3018, RA 109-10) and Kibler (Tr. 3042-3, RA 111-12) did not disclose this fact to Virginia residents who purchased Van-Pak from Registrant.

Respondents also misrepresented Van-Pak's future prospects.

Although the military had recently approved Van-Pak's tender of service, the prospectus showed that this merely authorized the company

^{25/} For example, Davis characterized Van-Pak as having a "revolutionary new process of containerized moving" (Tr. 1590, RA 34). Carr told his customer that Van-Pak had developed a new type of container (Tr. 1441, RA 19). This customer had requested a prospectus before purchasing Van-Pak but Carr--practicing what he had preached in the training sessions--told him that it "was fairly urgent" that he decide immediately because there were only a limited number of shares left (Tr. 1442, RA 20). Carr told another customer that Van-Pak was "one of the most promising issues that had come to his attention" and that "it couldn't miss" (Tr. 3016, 3018).

to compete for business at military posts and that only low bidding movers would actually get government contracts (Ex. 52). In addition, the president of Van-Pak himself testified that Van-Pak at the time of the offering had no contracts with the Defense Department or any other government agency, that the military's approval of the tender of service did not guarantee Van-Pak any income, and that he never told any of the petitioners that Van-Pak had any government contracts or anticipated receiving any (Tr. 6415-7, RA 173-5). Nevertheless, Hodgdon (Tr. 1227-9, RA 15-17) and Kibler (Tr. 11,567, 3042-3, RA 194, 111-12) told customers that Van-Pak had or expected to get government contracts. Davis (Tr. 1476-7, 1703, RA 23-4, 39) told his customers that Van-Pak expected substantial government contracts and that the company had a virtual "monopoly" on transporting the effects of overseas military personnel (Tr. 1833).

The Commission also found that the representations of Carr (Tr. 1446, 1467, RA 21-22), Haight (Tr. 1269, RA 18), and Kitain (Tr. 1956, RA 50) that Van-Pak's stock price would double, and Davis' representation that the stock was likely to double, triple or quadruple (Tr. 1476-7, RA 23-4) were fraudulent (Op. 17, JA 326).

Although petitioners claim (Br. 41-43) that they were given inside information about Van-Pak by its management which was not reflected in the prospectus, they did nothing to verify such information, they did not suggest to the company that the prospectus be amended and they did not temper their unqualified projections

of future corporate success with the disclosure, now openly conceded (Br. 43), that Van-Pak's public offering was the company's only hope of averting financial disaster: in effect, it was "go public or go broke."

2. U.S. Infrared Corporation ("USI")

The Commission found that Registrant, together with or aided and abetted by Kitain, violated the antifraud provisions in connection with an asserted "private placement" of USI stock through Registrant (Op. 17-18, RA 326-7). Kitain told a customer that if he purchased USI stock during the private offering he would be coming in "on the ground floor" since USI "would go public at a higher price later on" (Tr. 1016, RA 12, Tr. 11,353-4). There was no basis for this prediction; USI's only attempt at a public offering was an abortive effort that collapsed when the prospective underwriter rescinded its agreement (Tr. 5971-5, 12,813 et seq.; Ex. 12 B-D). The company became defunct (Px. 13v).^{26/}

3. Paragon Electrical Manufacturing Corporation

The Commission found (Op. 18-19, JA 327-8) that Registrant, together with or aided and abetted by Carr, violated the antifraud provisions in its sales of Paragon stock.

^{26/} Petitioners' complaint (Br. 44) that the Commission failed to find facts regarding purchases by Kitain and his father-in-law appears to be based on the erroneous theory that fraud is perfectly permissible as long as the perpetrator purchases some of the securities as to which he makes false and misleading statements.

In connection with Registrant's asserted "private placement" of Paragon's stock, Carr told a customer that Paragon had agreements with General Electric and Westinghouse for the distribution of its wire connector (Tr. 627, 641-2, RA 6-8), that the customer would make a "very nice profit from this stock after it went public" (Tr. 627, RA 6), and that there was talk of a stock split (Tr. 627, 647-8). There was no basis for these statements. The facts were that Paragon simply had no such agreements (Tr. 738), that a public offering was merely a possibility that never got past the discussion stage (Tr. 693, 756-8), and that no stock split was ever contemplated (Tr. 694; Ex. 56, 60).^{27/} Paragon went out of business soon after the "private placement" (Tr. 7644).

4. Apache Canadian Gas and Oil Program 1961

The Commission found that Registrant, together with or aided and abetted by Harper, made fraudulent representations in connection with Registrant's participation as underwriter in a registered offering of \$5,000 units of Apache Canadian Gas and Oil Program 1961 (Op. 19, JA 328). Harper sold a unit to Mrs. D, his financial planning client, who soon became dissatisfied and tried to get Harper to sell. He dissuaded her, first by writing that he knew of "several anxious

^{27/} The fact that Registrant acquired Paragon shares is irrelevant from the standpoint of appropriate disclosures to its customers.

buyers, . . . I urge and beseech you not to sell this" (Ex. 168, JA Tr. 2326-32), then by telling her in a written report that "Bids have run as high as \$25,000 per unit" (Ex. 165, RA 222), and finally by telling her that several buyers would pay \$35,000 (Tr. 2340-2, 3140; Ex. 166, Px. KK). These statements were false and misleading. Harper used the same technique on Dr. B, who had bought a unit for \$12,050 after the offering; Harper's "portfolio analysis" for Dr. B valued a unit at \$30,000, with a potential worth of \$100,000 (Ex. 383, RA 234). Although Harper testified that he obtained his figures from the corporate sponsor of the Apache Program (Tr. 6914-7, 6881-4), an officer of the sponsor testified that there was no basis for Harper's figures (Tr. 6541-3). Petitioners do not contest the Commission's findings (Br. 45).

5. Data Processing Corporation of America ("DPCA")

The Commission found that Davis violated the antifraud provisions in connection with the securities of DPCA. Although Davis was admittedly aware that a DPCA underwriting was only in the talking stage (Tr. 5676, 10,517-8), he nonetheless told a customer that there would shortly be a public offering of the stock at a price considerably above the \$3.50 per share paid by the customer and that market interest should

make the price "behave favorably after the public offering" (Ex. 44).

There was no basis for these representations.^{28/}

Offer and Sale of Unregistered Securities

The Commission found that Registrant, Hodgdon and Kitain in the offer and sale of USI stock and Registrant, Hodgdon and Carr in the offer and sale of Paragon stock, violated the registration provisions of Section 5 of the Securities Act of 1933, 15 U.S.C.

77e ("Securities Act"), and that Kitain and Davis violated these provisions in the offer and sale of DPCA stock (Op. 20-21, JA 329-30).^{29/}

Petitioners failed to sustain their burden of proving that there was any "private offering" exemption from registration.^{30/} As the Commission found and as petitioners virtually concede (Br. 43), the USI, DPCA and Paragon offerings were made to various inadequately informed persons who were not related to the issuers in such a way as to give

^{28/} Petitioners' assertion (Br. 45) that Davis made no profit from these transactions and purchased shares personally is without relevance to the question of whether he made fraudulent statements to his customers.

^{29/} Section 5 of the Securities Act prohibits the sale of any security unless a registration statement covering the security has been filed with the Commission and is in effect. Petitioners admit (Br. 43) that the securities of USI, DPCA and Paragon were unregistered.

^{30/} The "private offering" exemption derives from Section 4(2) of the Securities Act, 15 U.S.C. 77d(2), which exempts from the registration provisions of Section 5 "transactions by an issuer not involving any public offering."

them access to the same kind of information that a registration statement under the Securities Act would have supplied, nor did they otherwise possess such information (Op. 20, JA 329).

As previously noted, various petitioners also made false and misleading statements about these securities.

False Records

Petitioners admit (Br. 45) that Hodgdon told Registrant's salesmen and clerical staff to place the notation "unsolicited" on confirmation slips that were mailed to Virginia residents who purchased Van-Pak stock even though their purchase orders were in fact solicited. Haight and Adam admitted marking order tickets in this fashion (Tr. 85550, 12,039-43). The Commission concluded from these undisputed facts that Registrant, aided and abetted by Hodgdon, Haight and Adam, made false entries on its records in violation of the recordkeeping provisions of Section 17(a) of the Exchange Act, 15 U.S.C. 78q(a), and Rule 17a-3 thereunder, 17 CFR 240.17a-3.^{31/}

Registrant's motivation for marking solicited purchases by Virginia residents as "unsolicited" stemmed from the State of Virginia's ban on sales of Van-Pak stock in that state because of

^{31/} Section 17(a) and Rule 17a-3 require broker-dealers to keep certain records, including memoranda of each order (17a-3(a)(6)) and copies of all confirmations (17a-3(a)(8)).

a finding by state authorities that the company was insolvent. Hodgdon reacted to the prohibition by instructing his employees to sell to Virginia residents provided that orders were solicited outside the state, and that non-Virginia addresses were used for such transactions. However, if the Virginia purchaser had no non-Virginia address, order tickets and confirmations mailed to Virginia were to be marked "unsolicited" regardless of whether the purchases were in fact unsolicited (Tr. 35-6, 2129, 7134-7, 7671-3).

Failure to Amend Application for Broker-Dealer Registration

Petitioners admit (Br. 45-46) that on three occasions Registrant's application for broker-dealer registration was not amended to reflect the election of certain directors and officers. The Commission found this omission to be a violation by Registrant, aided and abetted by Hodgdon, of Section 15(b) of the Exchange Act 15 U.S.C. 78o(b), and Rule 15b3-1 thereunder, 17 CFR 240.15b3-1. Hodgdon testified that he had delegated the responsibility for preparing such amendments to his executive secretary and was unaware that they were not timely filed (Tr. 7487-8), but the Commission found that such delegation did not relieve Hodgdon of his obligation to make the amendments (Op. 22, JA 331). ^{32/}

^{32/} Petitioners' assertion (Br. 46) that the elections were recorded in Registrant's minute book and not otherwise concealed does not erase the fact that the Commission's records were rendered inaccurate by petitioners' failure to comply with even the simplest of the Commission's broker-dealer disclosure requirements.

Failure to Transmit Funds Promptly

Petitioners concede (Br. 46) that in connection with Registrant's participation in a public offering of Southeastern Mortgage Investors Trust ("Southeastern") securities underwritten by registrant, Registrant failed promptly to transmit to the issuer proceeds from sales of Southeastern stock. The Commission concluded that Registrant thereby violated Section 15(c)(2) of the Exchange Act, 15 U.S.C. 78o(c)(2), and Rule 15c2-4, 17 CFR 240.15c2-4, which provide that it is a fraudulent practice within the meaning of Section 15(c)(2) for a broker or dealer participating in a securities distribution to accept the proceeds unless such proceeds are "promptly transmitted" to the persons entitled to them (Op. 22, JA 331).

Although petitioners attempt to make light of this violation as an isolated incident, it is but further proof of their indifference to the letter as well as the spirit of the federal securities laws.

STATUTES AND RULES INVOLVED

Pertinent statutes and rules are set forth in the Statutory Appendix to this brief.

ARGUMENT

I. THE COMMISSION'S FINDINGS THAT PETITIONERS WILLFULLY VIOLATED THE FEDERAL SECURITIES LAWS ARE SUPPORTED BY SUBSTANTIAL EVIDENCE.

As this Court pointed out in Hughes v. Securities and Exchange Commission, 85 U.S. App. D.C. 56, 61, 174 F. 2d 969, 974 (1949), "The function of this Court upon review of orders of the [Securities and Exchange Commission], with respect to findings of fact by the Commission, is set forth in Section 25(a) of the Securities Exchange Act of 1934 thus: '* * * The findings of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. * * *'" (Footnote omitted.)^{33/} Accord, Section 10(e) (B) (5) of the Administrative Procedure Act, 5 U.S.C. 706(2) (E). The courts have consistently held that an administrative agency's findings of fact are presumed to be supported by substantial evidence.^{34/} A reviewing court's function is not to determine where the weight of the evidence lies but, rather, is "simply to see if the Commission's factual findings are supported by substantial evidence." Hughes v. Securities and Exchange Commission, *supra*, 85 U.S. App. D.C. at 61, 174 F. 2d at 974; accord, Consolo v. Federal Maritime Commission, 383 U.S. 607, 619-622 (1966).

33/ This Court has repeatedly held to this effect in cases involving administrative agencies. E.g., Texas International Airlines, Inc. v. CAB, et al. (Nos. 23,232 and 23,233, April 30, 1971, slip op. 23); Richardson v. Britton, 89 U.S. App. D.C. 391, 192 F. 2d 423 (1951).

34/ E.g., Keele Hair & Scalp Specialists, Inc. v. Federal Trade Commission, 275 F. 2d 18, 21 (C.A. 5, 1960); Steelco Stainless Steel, Inc. v. Federal Trade Commission, 187 F. 2d 693, 694-695 (C.A. 7, 1951).

Although petitioners assert (Br. 47-53) that the Commission's findings regarding their scheme to defraud "financial planning" clients were not supported by substantial evidence, they do not even attempt to make this claim in respect of the many other violations found by the Commission, relying instead on various arguments which we will show are either wholly irrelevant or clearly without merit. Even as regards the "financial planning" aspect of the case, it is evident that petitioners do not contest the irrefutable facts that appear in the record, but instead place emphasis on asserted facts that were not found by the Commission because they do not bear on the material elements of the scheme to defraud.^{35/} Thus, petitioners even now refuse to acknowledge

^{35/} For example, petitioners claim that their customers were not "disadvantaged" by the scheme to defraud (Br. 48). Since this is not a private action for damages, but a Commission disciplinary proceeding against a registered broker-dealer and its officers and employees, proof of pecuniary injury to customers is ancillary at most to the fundamental question of whether petitioners engaged in a course of conduct that operated as a fraud on public investors. If petitioners' contentions were to prevail, a broker-dealer could engage in the most reprehensible fraudulent scheme with impunity--making false and misleading statements and omitting to make material disclosures--as long as its customers could not prove they had lost money. Such a proposition is inherently inconsistent with the duties of full and fair disclosure imposed by the federal securities laws on all persons and particularly on members of the securities industry such as broker-dealers. The securities laws do not question the merits of particular securities or the soundness of the broker's advice; they ask only whether there has been full and fair disclosure of all material facts and adherence to reasonable standards of professional conduct.

the fundamental responsibilities that members of the securities industry owe to the investing public, persisting in the erroneous belief that it was perfectly proper and "reasonable" (Br. 53) to solicit the trust and confidence of investors by emotional appeals and investment gimmickry and without disclosing the self-serving economic motivation for these pernicious methods of operation.

A. Scheme to Defraud "Financial Planning" Clients

The Commission found that during a period of four years, extending from May 1960 to June 1964, Registrant and each of the individual petitioners engaged in a scheme to defraud "financial planning" clients in willful violation of the antifraud provisions of the federal securities laws and applicable Commission rules promulgated thereunder.^{36/} The effect of these provisions is to prohibit any person, and particularly broker-dealers, from engaging in "any act, practice, or course of business which operates . . . as a fraud or deceit upon any person"^{37/} and from employing "any device, scheme, or artifice to defraud."^{38/} As the Supreme Court emphasized in Securities and Exchange Commission v. Capital Gains Research Bureau, 375 U.S. 180, 195 (1963), this federal securities legislation must be construed "not technically and restrictively, but flexibly to effectuate its remedial purpose."

Petitioners' scheme involved two interrelated elements: First, petitioners embarked upon a broad and continuous appeal to public investors,

^{36/} Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78o(c)(1) and Rules 10b-5 and 15c1-2 promulgated thereunder, 17 CFR 240.10b-5 and 240.15c1-2. The applicable statutory and rule provisions are set forth in the Statutory Appendix.

^{37/} Similar language appears in each of the antifraud provisions. Section 17(a) of the Securities Act focuses on sales of securities; Section 10(b) of the Exchange Act encompasses any transaction in connection with the purchase or sale of securities; Section 15(c)(1) of the Exchange Act deals with the obligations of broker-dealers.

^{38/} See also Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

soliciting and inducing them — particularly "new investors" — to place their financial affairs in petitioners' hands, to repose full trust and confidence in petitioners' asserted skills and expertise. This appeal was conducted through frequent advertisements, telephone solicitations and personal contacts and interviews. Petitioners were trained, and trained their colleagues, to play upon the fears and desires of investors for financial security and well-being; they emphasized among themselves the fundamental gullibility of the unsophisticated or relatively unsophisticated investor and devised means of exerting psychological and economic pressures on prospective clients to enroll in Registrant's "financial planning" program. The program required that customers divulge their financial position to petitioners and enabled petitioners to determine how much business they could expect to squeeze from the client's existing securities portfolio, cash savings and life insurance.

Second, petitioners recommended securities purchases to financial planning clients that were purposefully designed to bring petitioners a large measure — a "quota" — of "high-commission" business. "Financial planning" was purveyed as comprehensive investment advice based on the individual needs of the particular customer and the investment characteristics of particular securities. However, one of the central elements of the financial planning concept was hidden from the view and evaluation of investors: the systematic emphasis on the sale of

securities that would generate the highest commissions, sales charges and trading profits for petitioners.^{39/}

In short, the Commission concluded that petitioners had failed to disclose, and even willfully concealed from financial planning clients, not only the fact that petitioners were not the "super-experts" they purported to be,^{40/} but also the critically material fact that there was a preconceived plan to stress certain high-commission securities sales that directly benefited petitioners, whatever may have been the consequences to their customers. The gist of the scheme did not depend upon the success of financial planning clients in reaching particular goals — although petitioners often falsely represented to such clients that they would soon be free of financial worries. It is therefore wholly irrelevant whether customers suffered losses or gains. The point is that they relied on the recommendations of petitioners without having been advised that those recommendations depended at

^{39/} Although petitioners concede that their business was high-commission oriented (Br. 14-15) — a fact not disclosed to customers — they attempt to justify this by asserting that customer accounts had little turnover. Of course, there is no evidence that investors with blue chip securities portfolios experience high turnover rates.

^{40/} It is ironic that petitioners advanced as grounds for leniency in the imposition of sanctions, when they were before the Commission, the fact that petitioners Davis, Kibler, Carr, Adam, Harper, and Kitain had not previously been employed as registered representatives of a broker-dealer. Petitioners certainly did nothing to convey their lack of experience in the securities business to their financial planning clients; to the contrary, these investors were affirmatively urged to rely on petitioners' much touted "expertise" and that of other employees of Registrant, such as an insurance "specialist" who specialized in getting investors to cash in their life insurance policies so as to free up funds for investment in high-commission securities.

least in part on a preconceived, systematic emphasis on high-commission business, i.e., securities underwritten by Registrant, securities sold in principal as opposed to agency transactions and sales of mutual funds, including Aberdeen Fund of which Hodgden was an affiliate.

Similarly, it was unnecessary for the Commission to show, as petitioners contend (Br. 51-52), that any particular number of financial planning clients were subjected to the machinations of the scheme. ^{41/}

It was sufficiently shocking — and clearly violative of the antifraud provisions — that Registrant and each of the individual petitioners engaged in the process of making recommendations, rendering falsely buoyant reports, and giving other assurances to any public investors without disclosing the material elements of the financial planning scheme: false and misleading solicitations and a preconceived, systematic emphasis on high-commission securities. ^{42/}

Although petitioners claim (Br. 52-53) that they did not knowingly participate in an agreed upon course of fraudulent conduct, it was unnecessary for the Commission to find that they subscribed to any formal "agreement"

^{41/} Petitioners' argument in effect posits the principle that a little fraud is perfectly permissible, particularly when the investors do not know that they are being defrauded and are therefore lulled into a false sense of security.

^{42/} There is, of course, nothing improper per se about the fact that certain types of securities — such as mutual funds and underwritten securities — carry much higher sales charges and commissions than do transactions in listed securities. Many broker-dealers deal in such high-commission business. It was petitioners' failure to disclose to their customers that "financial planning" was by its conception and nature a device to sell high-commission securities that constituted the scheme to defraud.

in light of the fact that each of the individual petitioners actively participated in the common undertaking evidenced by Registrant's sales techniques, both as to solicitation of customers and recommendations for the purchase of securities, without making appropriate disclosures to their clients.^{43/} In any event, there is ample evidence of concerted activity in Registrant's sales meetings and in the "teachings" of the managerial troika of Hodgdon, Haight and Carr to which the other petitioners so eagerly and evidently subscribed.

As the Commission concluded, petitioners' "conduct was clearly contrary to the basic obligation of professionals in the securities business to deal fairly with the investing public" (Op. 14, JA 323). This theme has been echoed many times in the decisions of the Supreme Court, this Court and other federal courts that have had occasion to consider the legal responsibilities that broker-dealers owe to their customers. In Securities and Exchange Commission v. Capital Gains Research Bureau, supra, 375 U.S. at 186, the Supreme Court emphasized:

"A fundamental purpose, common to these [securities] statutes, was to substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry."

Recognizing that securities transactions involve "intricate merchandise"^{44/} whose qualities should be assessed only after consideration

^{43/} See Blue v. United States, 138 F. 2d 351 (C.A. 6, 1943), certiorari denied, 322 U.S. 736 (1944); Oliver v. United States, 121 F. 2d 245 (C.A. 10), certiorari denied, 314 U.S. 666 (1941). The cases cited by petitioners on page 53 of their brief are not to the contrary.

^{44/} H.R. Rep. No. 85, 73d Cong., 1st Sess. 8 (1933).

of all relevant factors, this Court noted in Norris & Hirshberg v. Securities and Exchange Commission, 85 U.S. App. D.C. 268, 273, 177 F. 2d 228, 233 (1949), that "the investing and usually naive public needs special protection in this specialized field."^{45/} And the court in Chasins v. Smith, Barney & Co., 438 F. 2d 1167 (C.A. 2, 1971), holding that a broker-dealer who makes recommendations to his client at the client's request must disclose the fact that the broker-dealer is a market-maker^{46/} in the securities recommended, remarked at p. 1172:

"An investor who is at least informed of the possibility of such adverse interests due to his broker's market making in the securities recommended can question the reasons for the recommendations. The investor . . . must be permitted to evaluate overlapping motivations through appropriate disclosure, especially where one motivation is economic self interest" (Footnote omitted).

Petitioners gave their financial planning clients no opportunity at all to "evaluate overlapping motivations" that underlay recommendations to buy high-commission securities. To be sure, the customers could if they wished to do so read prospectuses that indicated the sales charge

^{45/} As the Court observed in Hanly v. Securities and Exchange Commission, 415 F. 2d 589, 595 (C.A. 2, 1969):

"The sensitivity of operations in the securities field and the availability of opportunities where those in a position of trust can manipulate others to their own advantage led Congress to pass the antifraud provisions"

See also Hughes v. Securities and Exchange Commission, *supra*; Charles Hughes & Co. v. Securities and Exchange Commission, 139 F. 2d 434 (C.A. 2, 1943), *certiorari denied*, 321 U.S. 786 (1944); Hiller v. Securities and Exchange Commission, 429 F. 2d 856 (C.A. 2, 1970).

^{46/} A "market-maker" ordinarily holds in its own account shares of the securities in which it "makes a market," i.e., makes offers to buy and sell at stated prices. It thus has an economic interest in such securities beyond that of a broker-dealer who buys and sells as an agent for his customer and has no capital at risk in such transactions.

or commission; they might even be advised that Registrant was the underwriter for a new issue they were encouraged to purchase. What they were not told was that petitioners' economic motivation was far broader than that disclosed in any prospectus or "pep talk" they may have received: petitioners systematically stressed high-commission securities; it was an integral part of their method of operation. The failure to disclose the practical reality of "financial planning" — rather than its promotional veneer — was hardly inadvertent. Indeed, it is difficult to imagine that petitioners' method of operation could have continued had their customers been made aware of what "financial planning" really meant in terms of the recommendations that would be made.^{47/}

In a business where the barriers to entry are relatively low, it is particularly important that high standards of conduct be observed by broker-dealers, especially when they hold themselves out to the public as competent to advise objectively and independently on the complex questions of securities investment. Petitioners violated the trust and confidence placed in them by their customers for reasons of economic self-interest. And if, even now, they can defend their conduct only by

^{47/} For example, customers knew nothing of the pressures placed on salesmen to fill sales quotas for high-commission securities; special bonuses for sales of mutual funds; increased salesmen's commissions on stocks that were too heavily inventoried and therefore required extra efforts to sell; arm-twisting of salesmen to sell the firm's underwritings.

claiming that few investors were "injured," they have surely proved themselves unfit for the public responsibilities that the securities business entails.

B. Fraudulent Statements in the Offer and Sale of Securities

In addition to finding a scheme to defraud "financial planning" clients, the Commission also found (Op. 15-20, JA 324-9) that petitioners had willfully violated the antifraud provisions of the federal securities laws by making false and misleading statements in connection with the offer and sale of securities issued by five unseasoned companies: Van-Pak, USI, Paragon, Apache and DPCA.^{48/} In each of these cases petitioners were found to have made representations and predictions, including flamboyant predictions that the price of the securities would skyrocket, for which they had absolutely no basis. As the court stated in Hanly v. Securities and Exchange Commission, 415 F. 2d 589, 596 (C.A. 2, 1969):

"A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders" (footnotes omitted).

Furthermore, the strict standards governing the conduct of persons selling securities are even more strict where the sales, as here, involve over-the-counter securities. Id. at 597. It is plainly improper to "recommend

^{48/} Registrant's violations pertained to Van-Pak, USI, Paragon and Apache; Hodgdon and Haight were found to have violated the anti-fraud provisions in connection with their sales of Van-Pak; Carr was found to have violated these provisions in his sales of Van-Pak and Paragon; Harper in his sales of Van-Pak and Apache; Kitain in his sales of Van-Pak and USI; Davis in his sales of Van-Pak and DPCA; and Kibler in his sales of Van-Pak.

Rule 10b-5, 17 CFR 240.10b-5, promulgated by the Commission under Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), makes it unlawful for any person "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security." Similar provisions are contained in Section 17(a) of the Securities Act, 15 U.S.C. 77q(a), dealing with sales of securities, and Rule 15c1-2 under the Exchange Act, 17 CFR 240.15c1-2, dealing with the obligations of broker-dealers.

a security unless there is an adequate and reasonable basis for such recommendation." ^{49/} Ibid.

Petitioners do not even seriously attempt to argue that the Commission's findings of fraud in the sale of USI, Paragon, Apache and DPCA were unsupported. ^{50/} They erroneously contend (Br. 59-61) that the Commission's findings of fraudulent statements in the offer and sale of Van-Pak were based solely on petitioners' price predictions and involved testimonial conflicts that were improperly resolved. As the Commission's findings make clear (Op. 15-17, JA 324-6), petitioners' fraud did not involve solely price predictions, although there is substantial evidence that there was no conceivable basis for assurances to customers that the stock would "double or better" in a short time or otherwise rapidly appreciate in price. ^{51/} In addition to price predictions, petitioners failed to disclose to purchasers of Van-Pak who were residents of Virginia that the State of Virginia had prohibited sale of the stock

^{49/} See also Nees v. Securities and Exchange Commission, 414 F. 2d 211, 219-220 (C.A. 9, 1969).

^{50/} Petitioners' argument (Br. 59-61) pertains almost entirely to the offer and sale of Van-Pak. In their Statement of the Case they obliquely refer to conflicts of testimony which they now suggest were improperly resolved (Br. 44-45). As the Commission noted in its opinion (Op. 26, n. 45, JA 335), apart from Van-Pak petitioners raised objection to only three such determinations and the Commission did not base any of its findings on the evidence as to which those determinations were made. Of course, petitioners cannot seek to raise objections in this Court which they did not present to the Commission.

^{51/} Petitioners suggest (Br. 61) that they had a basis for "optimism over Van-Pak's future prospects." Even if that were so--and the Commission found that it was not, particularly in view of the testimony of Van-Pak's president and the statements in the company's prospectus--"optimism" affords no basis for the extravagant prediction that a stock will double in price. Such predictions are inherently fraudulent because it is impossible to project with

in that state because of its finding that the company was insolvent.^{52/}
Petitioners also made many other representations that were demonstrably false: that Van-Pak had developed a new type of container; that the company would shortly pay dividends; that it had defense and other Government contracts; that "it couldn't miss."

Apart from the fact that Van-Pak did "miss," the representations in Van-Pak's prospectus, forming part of its registration statement filed with the Commission, painted an entirely different picture of the company's existing business and future prospects. Instead of limiting themselves to the information disclosed in the prospectus, petitioners directly contradicted its disclosures, although they had no basis for doing so.^{53/}

51/ (Continued)

accuracy the future price of any particular stock, and assurances in this respect by petitioners could only mislead investors into the assumption that they were purchasing a "sure thing" instead of a highly speculative security. As the court observed in United States v. Wolfson, 405 F. 2d 779, 785 (C.A. 2), certiorari denied, 394 U.S. 946 (1968), "no reliable expert technique has yet been developed or perhaps can ever be developed to ascertain with any degree of accuracy the future market price of securities or the effect of events upon it."

52/ It will be recalled that petitioners circumvented this ban by selling to Virginia residents at addresses in the District of Columbia or by marking the order tickets and confirmations "unsolicited." Thus, residents of Virginia were not advised that their own state authorities had found Van-Pak insolvent and hence inappropriate for purchase by residents--a fact that might become especially important if such residents later attempted to dispose of the stock through Virginia brokerage firms.

53/ The reports which petitioners claim to have received from the management of Van-Pak (Br. 41-42) do not provide any support for their sweeping representations, and Van-Pak's president testified that he had never told any representative of Registrant that the company had or anticipated getting any Government contracts or that any particular income could be guaranteed. Although purchasers of Van-Pak may have received a prospectus disclosing accurate facts about the company, the delivery of a prospectus does not, as petitioners appear to suggest (Br. 42), give broker-dealers a license to lie in their oral representations, particularly when the purchasers rely on such representations.

Consistent with their broader scheme to defraud, petitioners said what they thought was necessary to say in order to make a sale and omitted any material disclosures that might have dissuaded customers from following their recommendations.

Petitioners' challenge to the hearing examiner's determination to credit the testimony of customer witnesses instead of their own testimony is without merit. As the Commission noted (Op. 17, JA 326):

"The hearing examiner heard the witnesses, observed their demeanor, and noted that at least ten customers had testified to similar representations being made to them concerning Van-Pak Government contracts."

There was no testimonial conflict about the failure of petitioners to disclose that Virginia authorities had banned sales of Van-Pak in that state. Nor did petitioners completely contradict the testimony of their customers in other respects.^{54/} And to the extent that there were conflicts, it would have been superfluous for the examiner to have expressly stated in each instance that he believed the corroborating testimony of the investor witnesses--who had no financial stake in the outcome of the proceeding--rather than the self-serving declarations of petitioners.

Under the circumstances, the requirements of Section 8 of the Administrative Procedure Act, 5 U.S.C. 557, were satisfied since--for purposes of review by the Commission and this Court--there was no question

^{54/} For example, as the hearing examiner found (I.D. 112, JA 242), Hodgdon represented that Van-Pak "was a real flyer, a wild and wooly situation that held promise"

that the hearing examiner credited the unbiased testimony of the investors rather than that of the petitioners. Neither the hearing examiner nor the Commission was required to engage in an "over-elaboration of detail or particularization of facts"^{55/} in order to arrive at the conclusion, amply supported by the record, that petitioners had committed fraud in the offer and sale of securities.

^{55/} Stauffer Laboratories v. FTC, 343 F. 2d 75, 81-82 (C.A. 9, 1965); Coyle Lines v. United States, 115 F. Supp. 272, 276 (E.D. La., 1953). The cases cited on page 60 of petitioners' brief are not to the contrary. In the Scott Paper Co. case, the court could not conclude that the NLRB had exercised its "right" to credit the testimony of a union witness and discredit the testimony of management witnesses because "[n]owhere do the opinions imply less than full belief in management's testimony . . ." (emphasis added). No such problem is involved in this case since the hearing examiner's initial decision (I.D. 110-118, JA 240-8) clearly spells out the findings derived from each investor witness and it is clear that, at least by implication, the examiner discredited the salesman's testimony. The Klopp case, cited on page 61 of petitioners' brief, is distinguishable since the court there simply disagreed with the credibility determinations that had been made. Whatever the merits of that court's decision, there is no basis in the record of this case for disturbing the hearing examiner's decision not to credit the self-serving statements of petitioners, particularly since those statements did not rebut all of the evidence against them.

C. Offer and Sale of Unregistered Securities

The Commission found that Registrant, Hodgdon, Carr, Kitain and Davis had violated the registration provisions of the Securities Act of 1933 by offering and selling securities issued by USI, DPCA and Paragon when no registration statement as to such securities was filed or in effect.^{56/}

The basic statutory scheme of the Securities Act of 1933 ("Securities Act") contemplates that every transaction involving the offer or sale of securities through the use of instruments of interstate commerce or the mails must be accompanied by the "full and fair disclosure" afforded by registration of the securities with the Commission and delivery of a statutory prospectus containing such information about the securities and the company which is issuing them as to enable prospective purchasers to make an informed investment decision. Thus, Section 5(c) of the Act, 15 U.S.C. 77e(c), prohibits "any person, directly or indirectly" from offering securities unless a registration statement has been filed with the Commission, and Section 5(a) of the Act, 15 U.S.C. 77e(a), prohibits "any person, directly or indirectly" from selling securities unless a registration statement is in effect.

Petitioners have not, in this Court or before the Commission, denied the fundamental fact that no registration statement was ever filed

^{56/} Registrant and Hodgdon were found to have violated these provisions in the offer and sale of USI and Paragon. Kitain's violations involved USI and DPCA stock; Carr's violations involved Paragon stock; and Davis's violations involved DPCA stock.

or was in effect with respect to the shares of USI, DPCA or Paragon stock they offered and sold to their customers. Instead, they claim that the transactions were exempt from registration under Section 4(2) of the Securities Act, 15 U.S.C. 77d(2), as "not involving any public offering."^{57/} However, petitioners not only concede that they had the burden of establishing the availability of this exemption (Br. 59),^{58/} but in effect admit that they failed to meet that burden. Relying entirely upon the fact that the number of persons to whom the unregistered securities were offered and sold was relatively small, petitioners ignore the clear and unmistakable holdings of the Supreme Court and of every other court which has had occasion to pass upon the availability

^{57/} The reference in petitioners' brief (Br. 54) to Section 4(1) reflects the numbering of the Securities Act before 1964, when the Act was amended. Although the so-called "private offering" exemption became Section 4(2), its wording remained identical.

^{58/} See, e.g., Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119, 126 (1953). As more recently emphasized in United States v. Custer Channel Wing Corp., 376 F. 2d 675, 678 (C.A. 4), certiorari denied, 389 U.S. 850 (1967):

"[T]he terms of the exemption must be strictly construed against the one claiming it, and the burden of establishing the exemptive character of the transaction rests on him. . . ."

of the private offering exemption.^{59/}

The court's observation in Gilligan, Will & Co. v. Securities and Exchange Commission, 267 F. 2d 461, 467 (C.A. 2), certiorari denied, 361 U.S. 896 (1959), is particularly apt:

^{59/} Petitioners strain at great length (Br. 54-59) to find some support for their argument that the protections of the federal securities laws may be dispensed with when only a few investors are involved. They refer to a 1946 interpretative release (since superceded by Securities Act Release No. 4552 (November 6, 1962)) which was not a Commission "rule" or "regulation" but an expression of staff views. While quoting the staff's views at that time that "under ordinary circumstances an offering to not more than approximately twenty-five persons . . . presumably does not involve a public offering," they omit to quote the most critical language in the release: "[T]he determination of what constitutes a public offering is essentially a question of fact in which all surrounding circumstances are of moment. In no sense is the question to be determined exclusively by the number of prospective offerees." 11 Fed. Reg. 10952 (1946). Whatever may have been the merits of the staff's views in 1946, it is clear that petitioners were not entitled to rely upon those views in 1960 and 1961 in light of the Supreme Court's intervening decision in the Ralston Purina case, discussed below, and the other federal court decisions interpreting the private offering exemption. Petitioners' suggestion that Section 19(a) of the Securities Act, 15 U.S.C. 77s(a), insulated them from findings of violations is equally erroneous since that provision requires conformity with a Commission "rule or regulation," and the interpretative release involved was neither of these, but merely an expression of staff views promulgated without notice and opportunity for public comment and without the explicit endorsement of the Commission. Finally, there can be no doubt that the transactions in which petitioners engaged were violative of the Securities Act under even the most permissive construction of the interpretative release upon which they purport to rely. While an offering to no more than 25 persons may be deemed non-public "under ordinary circumstances," the circumstances of the USI, DPCA and Paragon offerings were anything but "ordinary," involving -- as the Commission found -- not only investors who were inadequately informed about the issuers, but blatantly false and misleading statements and omissions on the part of petitioners giving rise to violations of the antifraud provisions as well as the registration provisions of the Securities Act. It strains credulity to imagine that the Commission or any member of its staff would have thought that the protections and disclosures mandated by the Securities Act could be abandoned by a simple 25-offeree rule of thumb under circumstances such as these.

"Petitioners argue . . . that there is an exception . . . [from the registration requirements of the Securities Act] for cases in which the number of offerees or purchasers is small. In reliance on such a standard they assert that the [record] discloses the existence of only four specific purchasers, and that therefore . . . the petitioners' transactions were exempt because the issue was not public. We do not agree."

In Katz v. Amos Treat & Co., 411 F. 2d 1046, 1053, 1054 (C.A. 2, 1969), ruling inappropriate any "magic figure" for determining whether an exemption was proved, the court emphasized:

"The purpose of the exemption was to exclude from the registration requirement transactions 'where there is no practical need for its application or where the public benefits are too remote.' H.R. Rep. No. 85, 73d Cong., 1st Sess. 5 (1933)."

Since "[t]he principal and essential purpose of the 1933 Act is to protect investors by requiring registration with the Commission of certain information concerning securities offered for sale," Gilligan, Will & Co. v. Securities and Exchange Commission, supra, 267 F. 2d at 463, the applicability of the statutory exemptions "should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'" Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119, 125 (1953).

Without exception, the courts have recognized that the Supreme Court in the Ralston Purina case "clearly rejected a quantity limit" in determining the availability of an exemption. Gilligan, Will & Co. v. Securities and Exchange Commission, supra, 267 F. 2d at 467. Indeed, the Supreme Court could not have been more explicit: "[T]o be public an offer need not be open to the whole world. . . . [T]he statute would seem to apply to a 'public offering' whether to few or many. . . ."

Securities and Exchange Commission v. Ralston Purina Co., supra,

^{60/}
346 U.S. at 123, 125.

Thus, the burden of proving the availability of the private offering exemption is met not by proof of a small number of offerees, but by proof that those offerees did not require the protections of the Securities Act which would be afforded by registration of the securities offered. As the court noted in United States v. Custer Channel Wing Corp., 376 F. 2d 675, 678 (C.A. 4, 1967), certiorari denied, 389 U.S. 850 (1967):

"Schedule A of the Securities Act, 15 U.S.C. §77aa . . . lists 32 categories of information that should be included in a registration statement. This type of information is designed to protect the investor by furnishing him with detailed knowledge of the company and its affairs to make possible an informed investment decision. A purchaser of unregistered stock must be shown to have been in a position to acquire similar information about the issuer" (footnote omitted).

The Commission explicitly found that the "USI, DPCA and Paragon offerings were made to various inadequately informed persons who clearly

^{60/} Petitioners attempt to draw comfort from the Commission's position before the Supreme Court to the effect that an offering to a large number of persons could not be a non-public offering (Br. 56), while ignoring the decision of the Court itself. The Court noted that the Commission could use "some kind of numerical test in deciding when to investigate particular exemption claims," 346 U.S. at 125, but made it absolutely clear that as a matter of law the existence of an exemption from registration did not depend upon the number of offerees.

did not occupy a relationship to the issuers giving them access to the same kind of information that a registration statement under the Securities Act would have supplied, nor did they possess such information" (Op. 20, JA 329). ^{61/} Far from contesting this finding or suggesting a shred of evidence in the record to suggest that it was unsupported, petitioners concede that "in no instance could it be said that investors received all of the information which would have been provided to them by a full registration . . ." (Br. 43). Not only is it evident that the investors did not receive the quantity and quality of information necessary to sustain the claimed exemption, but it is apparent they were viciously victimized by the wildly flamboyant and exaggerated predictions and representations of petitioners. An exemption from the registration provisions of the Securities Act was not available.

^{61/} While some of the offerees may have been "sophisticated" (which petitioners seem to equate with a willingness to take risks (Br. 43)), "[s]ophistication is not a substitute for 'access to the kind of information which registration would disclose.'" United States v. Custer Channel Wing Corp., supra, 376 F. 2d at 678. In any case, even a sophisticated investor has the right to know what he is buying so that he can fully appreciate the risks he is taking.

D. Other Violations

As pointed out earlier, at pp. 43-45, the Commission found that various of the petitioners willfully violated applicable laws and Commission rules regarding the keeping of accurate records, the amendment of broker-dealer registration forms and the prompt transmittal to the issuer of the proceeds from the distribution of its securities.^{62/} Petitioners do not even attempt to suggest any error in the Commission's findings in their argument; in their Statement of the Case, they offer only cryptic explanations of this clear misconduct (Br. 45-46).^{63/} Although petitioners attempt to make light of their violations, they are but further proof of their indifference to the letter, as well as the spirit, of the federal securities laws. It is noteworthy that although petitioners paid detailed attention to the orderly and profitable operation of their "financial planning" scheme, even now they attempt to excuse non-compliance with the recordkeeping and operational rules of the Commission as mere inadvertence.

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- ^{62/} Registrant, Hodgdon, Haight and Adam were found to have willfully made or participated in the making of false entries on the firm's records; Registrant and Hodgdon were found to have willfully failed to amend the firm's application for broker-dealer registration; Registrant was found to have willfully failed to transmit the proceeds of a public offering to the issuer.
- ^{63/} For example, petitioners do not deny that the sales of Van-Pak stock to Virginia residents were solicited by them, but that they marked the order tickets and confirmations as "unsolicited." While this was demonstrably part of petitioners' scheme to circumvent the State of Virginia's prohibition on the sale of Van Pak stock in that state--because of a finding by Virginia authorities that the company was insolvent--petitioners suggest (Br. 45) that the phrase "unsolicited" was meant to have a "secondary meaning"; namely, that the sales were solicited. This devious line of analysis is characteristic of petitioners' view of their responsibilities under the federal securities laws, but hardly consonant with the laws themselves.

II. THE ADMINISTRATIVE PROCEEDINGS WERE CONDUCTED IN CONFORMITY WITH ALL APPLICABLE STANDARDS OF PROCEDURAL FAIRNESS AND DUE PROCESS.

Petitioners contend (Br. 61-66, 70-72) that the Commission's administrative proceedings were infected with procedural errors in several respects. They argue on the one hand that the Commission "prejudged" the merits of the case (Br. 61-63), and on the other that the lengthy record upon which the Commission's order was based is "too stale" (Br. 70), requiring outright dismissal of the charges against them. They suggest that the Commission had clearly indicated its views as to petitioners' conduct three years before the institution of the administrative proceedings (Br. 1-3), but that they were inadequately advised as to the nature of the charges against them (Br. 64-66). They even complain of the Commission's determination not to sustain all of the charges asserted in the order instituting the proceeding and found by the hearing examiner in his initial decision, from which they appealed to the Commission (Br. 65-66).

These contentions are not only mutually inconsistent, but each considered separately is utterly spurious.^{64/}

A. There Was No Prejudgment of the Charges Against Petitioners.

Petitioners argue (Br. 61-63) that the Commission prejudged those

^{64/} Petitioners do not press in this Court their objections before the Commission respecting the Commission's determination to institute public, rather than private, proceedings. As the Commission noted (Op. 24, JA 333), Section 22 of the Exchange Act, 15 U.S.C. 78v, explicitly permits public proceedings and the decision whether to institute such proceedings rests in the Commission's discretion.

aspects of the proceeding dealing with the "financial planning" scheme because some of the elements of that scheme were discussed in a report prepared by the Commission's staff pursuant to the direction of the Congress. As the Commission pointed out in its opinion (Op. 22-24, JA 331-3), the Special Study of Securities Markets^{65/} represented primarily the work of a separate staff established within the Commission for the purpose of reporting to Congress, pursuant to Section 19(d) of the Exchange Act, 15 U.S.C. 78s(d), on the adequacy of investor protection in the securities markets. The Commission made no findings of fact or law nor did it have before it any administrative record upon which to make any such findings.

After the Special Study Report was submitted to the Congress, the Commission issued an order of investigation for the purpose of enabling its regular enforcement staff to make an independent investigation of Registrant. This investigation, begun in late 1964, culminated in an order for proceedings issued on March 2, 1966. The order for proceedings was explicitly based upon allegations of the Commission's staff and asserted many securities violations not even hinted at in the Special Study Report. It was only after protracted hearings, during which petitioners -- as they have noted (Br. 5-6) -- "devoted weeks" to the presentation of "extensive proof," "witness after witness," and "a vast

^{65/} H. Doc. No. 95, Pt. 1, 88th Cong., 1st Sess. 109-110, 261-262 (1963).

amount of testimony," that an administrative record existed from which the hearing examiner could draw findings and conclusions for his initial decision, filed May 15, 1969. Dissatisfied with the examiner's decision, petitioners requested review by the Commission, whose own findings and opinion were "based upon an independent review of the record" (Op. 3, JA 312).

There was neither prejudice in fact nor even the slightest appearance of prejudice because no commissioner participating in the decision had been affiliated in any way with the Commission at the time of the 1963 Special Study.^{66/} Even if particular commissioners were familiar with the Special Study Report -- which is, of course, a public document -- it is obvious that they could not simply abandon their official responsibilities because of such knowledge, thereby insulating petitioners from any findings of violations and the imposition of sanctions.

66/ Petitioners' reliance on the cases cited on page 62 of their brief is misplaced. The court in Continental Box Co. v. NLRB, 113 F. 2d 93, 96 (C.A. 5, 1940), refused to sustain a broad claim of agency prejudice, noting that any such claim must be supported by evidence of "suppressive and exclusionary rulings and actions, designed to prevent and preventing a fair hearing." The suggestion that the record in this case discloses any such disregard for procedural due process is so totally without basis that it can only be characterized as a sweeping smear tactic intended to impugn the integrity of the Commission and its staff. The other cases cited by petitioners deal with specific challenges to the participation of one agency member who was asserted to have formed an opinion or otherwise to have apparently prejudged the merits of the case outside his quasi-judicial role. These cases are thus based upon provisions of the Administrative Procedure Act requiring separation of functions (5 U.S.C. 554(c)) and the conduct of proceedings "in an impartial manner" (5 U.S.C. 556). Petitioners did not file any affidavit of personal bias or other disqualification against any member of the Commission, as required by the impartiality provisions of the Act, 5 U.S.C. 556, nor have they asserted or shown that any member of the Commission participated in the administrative proceeding in a prosecutorial capacity prior to

If petitioners' argument were carried to its logical conclusion, a routine Commission order of investigation would preclude the Commission from subsequently bringing an administrative proceeding because the Commission might have become familiar with certain aspects of the case during the investigation.

It would have been unthinkable for the Commission simply to have ignored the findings of the Congressionally-authorized Special Study staff. The only appropriate question before this Court is whether the record in this case contains substantial evidence to support the Commission's findings of violations.^{67/}

66/ (continued)

becoming a commissioner -- the disqualifying factor in Amos Treat & Co. v. Securities and Exchange Commission, 113 U.S. App. D.C. 100, 306 F. 2d 260 (1962).

The fact is that only one of the four commissioners participating in the Commission's decision was even a member of the Commission at the time the administrative proceedings were instituted. There can be no claim of prejudgment or lack of impartiality on the part of any individual commissioner, and this Court should not countenance petitioners' attempt to discredit the agency itself for having fulfilled its statutory responsibilities by instituting revocation proceedings against them after an earlier statutory investigation disclosed possible securities law violations.

67/ Even if there had been prejudgment in fact, which we do not concede, the "rule of necessity" would have nonetheless required the Commission to go forward with its administrative proceedings, since the Commission is the only agency authorized by law to revoke the registration of registered broker-dealers and to bar persons from affiliation with such broker-dealers. See, e.g., FTC v. Cement Institute, 333 U.S. 683, 701-703 (1948); Pangburn v. CAB, 311 F. 2d 349, 358 (C.A. 1, 1962); San Francisco Mining Exchange v. Securities and Exchange Commission, 378 F. 2d 162, 168 (C.A. 9, 1967). Petitioners' suggestion (Br. 62-63) that their violations could have been referred to the National Association of Securities Dealers or a federal District Court for "independent" determination ignores the fact that only the Commission can bar them

(continued)

B. Petitioners Received Adequate Notice of the Charges Against Them.

Petitioners' argument (Br. 64-66) that the Commission's order instituting proceedings was overly broad does not provide any basis for the conclusion that they suffered the irreparable prejudice necessary to sustain a claim of denial of due process. The order itself clearly complied with the notice requirements of the Administrative Procedure Act,^{68/} and petitioners' complaint appears to emanate primarily from the fact that they were alleged to have committed a large number of securities law violations -- a fact for which the Commission can hardly be blamed.

As the court noted in Curtiss-Wright Corp. v. NLRB, 347 F. 2d 61, 72 (C.A. 3, 1965):

"The propriety of [an administrative] pleading is today judged by its effectiveness as a mechanism for giving an adverse party notice of the claim upon which relief is sought . . . the absence of specifics being tolerated where there has been no special showing of detriment" (footnote omitted). ^{69/}

^{67/} (continued)

from the securities business. In any case, decisions by the NASD are appealable to the Commission and a Commission decision based on the entry of an injunctive order is nonetheless the product of an administrative proceeding based upon an administrative record. Thus, petitioners' suggested alternatives merely demonstrate the basic invalidity of their argument.

^{68/} Section 5(a) of the Administrative Procedure Act, 5 U.S.C. 554(a), requires only that: "Persons entitled to notice of an agency hearing shall be timely informed of (1) the time, place, and nature thereof; (2) the legal authority and jurisdiction under which the hearing is to be held; and (3) the matters of fact and law asserted."

^{69/} See also Mansfield Journal Co. v. FCC, 86 U.S. App. D.C. 102, 180 F. 2d 28 (1950); Akers Motor Lines v. United States, 286 F. Supp. 213, 225 (W.D. N.C., 1968).

Petitioners demonstrate no prejudice, but instead rely upon the argument that prejudice was "inherent" because the Commission did not find all of the violations alleged in the order for proceeding and found by the hearing examiner (Br. 65-66).^{70/} Although it is not disputed that the Commission's staff introduced an enormous amount of evidence on such alleged violations (Br. 7-8), petitioners now fault the Commission

^{70/} Petitioners misread the cases they cite on pages 65-66 of their brief. Morgan v. United States, 304 U.S. 1, 18 (1938), merely holds that "the right to a hearing embraces . . . a reasonable opportunity to know the claims of the opposing party and to meet them." No due process objections can arise as long as the requisite notice is given in the order instituting the proceeding or "at some point prior to the close of the hearing." NLRB v. Tennesco Corp., 339 F. 2d 396, 400 (C.A. 6, 1964). Douds v. International Longshoremen's Ass'n., 241 F. 2d 278 (C.A. 2, 1957), discusses the technical distinction between a "charge" and a "complaint" in proceedings under the National Labor Relations Act, hardly relevant to the question of what constitutes adequate notice in administrative proceedings governed solely by the Administrative Procedure Act's minimal notice provisions. Similarly, Burkett v. United States, 402 F. 2d 1002 (Ct. Cl., 1968), involves an interpretation of the specific notice requirements of the Veterans' Preference Act, which mandates a far more detailed specification of charges and evidence than has ever been held to be required under the Administrative Procedure Act. Rodale Press v. FTC, 132 U.S. App. D.C. 317, 322, 407 F. 2d 1252, 1257 (1968), holds that an administrative agency cannot change its legal theory without giving the respondent notice of such change and "the opportunity to present argument under the new theory of violation. . . ." Petitioners' contention (Br. 65-66) that the Commission changed its theory is without support in the record; what happened was that the Commission declined to make findings of certain violations -- principally those dealing with representations as to rate of return on real estate securities -- even though those violations were clearly spelled out in the order for proceedings (paragraph II.B.14.e) and in the prosecutory staff's More Definite Statement and were found to have been committed by the hearing examiner (Op. 28, JA 337). In effect, petitioners ask this Court to chastize the Commission for having found in their favor on some of the issues involved in the proceeding. The most cursory examination of petitioners' requests for findings of facts and briefs before the hearing examiner and the Commission leaves no doubt that petitioners were amply aware of the charges against them, and at no point in the hearings did they protest their ignorance of these charges and request further clarification.

because it decided in their favor with respect to certain of these allegations. Petitioners would have doubtless raised a cry of "prejudgment" had the Commission found against them on those issues.

The courts have uniformly held that respondents in administrative proceedings have no right to pre-hearing discovery, including discovery of the names of witnesses.^{71/} Petitioners concede (Br. 5) that the hearing examiner granted them substantial information in addition to that contained in the order for proceedings. And they do not complain that they were denied any necessary adjournments in the course of the hearings to prepare themselves to meet any "surprise" evidence that may have been introduced.^{72/} In fact, petitioners do not even complain that they were on any occasion surprised by the evidence presented against them. Their claim of inadequate notice is clearly frivolous.

C. The Commission Did Not Abuse its Discretion in Denying Petitioners' Motion to Reopen the Record.

Petitioners repeatedly and caustically criticize the protracted nature of the administrative proceedings (e.g. Br. 70)^{73/} (to which,

71/ Dlugash v. Securities and Exchange Commission, 373 F. 2d 107, 110 (C.A. 2, 1967); NLRB v. Interboro Contractors, 432 F. 2d 854, 858-859 (C.A. 2, 1970).

72/ See Montana Power Co. v. FPC, 87 U.S. App. D.C. 316, 185 F. 2d 491 (1950), certiorari denied, 340 U.S. 947 (1951).

73/ Petitioners do not even attempt to show that they suffered any prejudice as a result of the lengthy proceedings; to the contrary, they were able to remain in business during the pendency of the proceedings. To the extent that petitioners had any remedy under the Administrative Procedure Act to "compel agency action unlawfully withheld or unreasonably delayed" (5 U.S.C. 706(e)), they waived that remedy, first by failing to seek an order from the hearing examiner or the Commission setting earlier hearing dates, and second by failing to seek a mandatory order from the "reviewing court" to compel the setting of such dates. The record in this case is replete with requests by petitioners for adjournments; it is silent as to requests for an accelerated hearing or briefing schedule.

however, they admit having added "many weeks" through the presentation of "extensive proof," "witness after witness," and "a vast amount of testimony" (Br. 5-6)). Nonetheless, petitioners sought to protract these proceedings even further by moving to reopen the record and adduce additional evidence on the question of sanctions. This motion was not made until after the hearing examiner had handed down his initial decision finding violations and imposing sanctions upon petitioners.

Petitioners' purpose in seeking to reopen the record was twofold: First, they sought to show that the four month suspension of Registrant which the hearing examiner deemed appropriate would have amounted to forcing Registrant out of business. Although we regard this contention as lacking in merit, the Commission's final order, which superceded the hearing examiner's initial decision, revoked Registrant's broker-dealer registration; accordingly, this point has become moot. Second, petitioners sought to show that Registrant under the "leadership of Haight" had improved its operational methods so as to reduce the possibility of future securities law violations. Yet as the Commission noted in its minute order of June 25, 1969, denying petitioners' motion (JA 305-7):

"[Petitioners] had an ample opportunity at the hearings to adduce evidence showing how Haight had 'formulated supervisory policy' at registrant in view of the fact that he had served as its chief executive officer for three years by the time the hearings were concluded. In fact, [petitioners'] proposed findings of fact submitted to the hearing examiner . . . detail evidence in the record showing assertedly 'significant' changes made in the nature of registrant's business and procedures. . . ."

Thus, petitioners failed to make the requisite showing under Rule 21(d) of the Commission's Rules of Practice, 17 CFR 201.21(d), that the additional evidence sought to be adduced was "material and that there were reasonable grounds for failure to adduce such evidence at the hearing. . . ." In reaffirming its denial of petitioners' motion in its opinion (Op. 27, JA 336), the Commission again pointed out that introduction of the proposed evidence would have unjustifiably prolonged the proceedings, "particularly since the evidence sought to be introduced appeared essentially cumulative."

If respondents in administrative proceedings were free perpetually to "refresh" the record upon the entry of an adverse order, there would be no end to such proceedings and securities violators could remain in business simply by adducing continuing proof of their existing compliance with the law. This would be an odd, not to say expensive, way of administering a statute which calls for sanctions when violations have been found -- not for perpetual litigation.

As the Supreme Court noted in ICC v. Jersey City, 322 U.S. 503, 514-515 (1944):

"Administrative consideration of evidence . . . always creates a gap between the time the record is closed and the time the administrative decision is promulgated. This is especially true if the issues are difficult, the evidence intricate, and the consideration of the case deliberate and careful. If upon the coming down of the order litigants might demand rehearings . . . because some new circumstance has arisen, some new trend has been observed, or some new fact discovered, there would be little hope that the administrative process could ever be consummated in an order that would not be subject to reopening. . . ."

Thus, "it has been held consistently that rehearings before administrative bodies are addressed to their own discretion. . . . Only a showing of the clearest abuse of discretion could sustain an exception to that rule."

United States v. Pierce Auto Freight Lines, 327 U.S. 515, 535 (1946).

These principles were recently reiterated by the Court in United States v. ICC, 396 U.S. 491, 520-522 (1970).^{74/}

The assertedly miraculous transformation of Registrant and its associates from consistent securities violators to supposedly consistent law abiders^{75/} took place long before the hearing examiner's decision -- and petitioners could have moved to reopen the record at any time between the end of the hearings and the decision. Thus, the Commission clearly acted within its discretion by denying petitioners a last ditch effort to further protract the proceedings with evidence that could have been, and to a great extent already had been, presented in the course of the lengthy hearings that preceded the initial decision.

^{74/} The Court has also emphasized that those seeking to reopen the record in an administrative proceeding must show a "valid reason for failure" to adduce the proffered evidence at an earlier time. ICC v. Parker, 326 U.S. 60, 73-74 (1945); see also Merritt, Vickers, Inc. v. Securities and Exchange Commission, 353 F. 2d 293, 297 (C.A. 2, 1965).

^{75/} Although petitioners would have this Court believe that their conduct has been beyond reproach since the institution of the Commission's administrative proceeding, on December 17, 1970 a District Business Conduct Committee of the National Association of Securities Dealers found, pursuant to an offer of settlement, that during 1969 Registrant had violated the NASD's markup policy (charging customers too much in principal transactions); during 1969 Registrant executed sales for its own account or purchases for the account of customers when it had fails to deliver and fails to receive of 120 days or older, in violation of the NASD's Emergency Rules; and during 1968 and 1969 Registrant failed to submit monthly reports of fails to deliver and fails to receive of 120 days or older (thereby concealing its violations of the back office rules). Registrant was censured and fined \$2,000. Haight & Co., Complaint W-211, District 10, NASD.

III. THE COMMISSION PROPERLY EXERCISED ITS POWER AND DISCRETION TO BAR PETITIONERS FROM THE SECURITIES BUSINESS

Confronted with a multiplicity of securities violations evidencing a wanton disregard for virtually every facet of the laws and regulations adopted by Congress and the Commission for the protection of public investors,^{76/} the Commission concluded that Registrant's registration as a broker-dealer should be revoked, that it should be expelled from the two self-regulatory organizations of which it was a member, and that each of the individual petitioners^{77/} should be barred from association with any broker or dealer. Petitioners challenge the imposition of these sanctions, contending that the Commission did not make adequate findings (Br. 67-69), that they were "punished" for having engaged in litigation (Br. 66-67), and that the sanctions were based upon a "stale" record (Br. 70-72). These contentions are effectively rebutted by the Commission's own findings and opinion (Op. 26-28, JA 335-7).

^{76/} Petitioners were found to have violated the antifraud provisions, the securities registration provisions, the broker-dealer registration provisions and the books and records provisions of the federal securities laws and applicable Commission rules promulgated thereunder. These provisions are the heart of the Securities Act and the Exchange Act and constitute the minimal standards of business conduct to which every broker-dealer and its associates bind themselves upon becoming registered as such under Section 15 of the Exchange Act, 15 U.S.C. 78o.

^{77/} Sections 15(b)(5), 15(b)(7), 15A(1)(2) and 19(a)(3) of the Exchange Act, 15 U.S.C. 78o(b)(5), 78o(b)(7), 78e-3(1)(2) and 78s(a)(3), grant the Commission power to impose such sanctions upon a finding that it is "in the public interest" to do so. There are only two alternative types of sanctions: a censure or a suspension for a period not exceeding 12 months.

Each of the factors urged by petitioners as grounds for a minimal sanction or no sanction at all was considered by the Commission and weighed on the scales of its discretion: the lapse of time since the violations; the damage that may have been suffered as a result of publicity; the measures adopted by Registrant to prevent further violations;^{78/} Hodgdon's departure from the securities business; Hodgdon's direction of the other petitioners'; the inexperience of Davis, Kibler, Carr, Adam, Harper and Kitain; and the fact that petitioners had not been previously involved in disciplinary proceedings. Against these considerations, the Commission was also required to and did weigh the nature, extent and seriousness of the violations found. The Commission concluded "that the various mitigative factors cited are insufficient to overcome the serious fraud and other violations of the respondents" (Op. 28, JA 337).

^{78/} As previously noted, petitioners sought to introduce additional evidence of a cumulative nature on this point after the hearings had been concluded and the initial decision of the hearing examiner had been rendered. Although the Commission denied petitioners' motion for leave to adduce additional evidence, it did consider the evidence already in the record as to the asserted corrective actions undertaken by petitioners. Thus, there is no basis for petitioners' assertion (Br. 72) that the Commission did not take into consideration post-violation conduct, in accord with Beck v. Securities and Exchange Commission, 413 F. 2d 832 (C.A. 6, 1969), 430 F. 2d 673 (C.A. 6, 1970).

As this Court recently observed in O'Leary v. Securities and Exchange Commission, 137 U.S. App. D.C. 420, 423-24 F. 2d 908, 911-12 (1970):

"Congress has bestowed broad and far-reaching authority on the Commission in the enactment of sections 15(b)(5) and (7) of the Securities Exchange Act. The authorization empowers the Commission to bar any person from association with a broker or dealer if . . . it finds that such barring 'is in the public interest' and that the charged conduct constitutes willful violation of the Act. 'The Commission is given the duty to protect the public. What will protect the public must involve, of necessity, an exercise of discretionary determination. This court ordinarily should not substitute its judgment of what would be appropriate under the circumstances in place of the Commission's judgment as to measures necessary to protect the public interest.'
" 79/

In the exercise of its discretion, the Commission determined that the willful violations of the federal securities laws it had found were so serious--involving a "nefarious scheme to defraud financial planning clients" as well as "fraudulent representations to customers in the offer and sale of various securities," the offer and sale of unregistered securities and other violations (Op. 28, JA 337)--that the public interest required petitioners' exclusion from the securities business.

Petitioners appear exceptionally troubled by the fact that the Commission's conclusion in this respect differed in some respects from that of its hearing examiner, who was of course its subordinate

79/ See also American Power & Light Co. v. Securities and Exchange Commission, 329 U.S. 90, 112-113 (1946); Tager v. Securities and Exchange Commission, 344 F. 2d 5, 9 (C.A. 2, 1965).

80/ employee. While the hearing examiner's analysis of the relevant factors may have led him to conclude that it was not necessary to bar all of the petitioners, the Commission's own analysis compelled it to conclude that the public interest could be adequately served only by excluding Registrant and each of the petitioners from the securities business. There was ample support for this conclusion and for the Commission's exercise

81/ of discretion. To parallel this Court's remarks in the O'Leary case, supra, 137 U.S. App. D.C. at 424, 424 F. 2d at 912:

"Although petitioners do not challenge the Commission's legal authority to increase the sanctions imposed by the hearing examiner, our views on the point do not differ greatly from those expressed in several recent decisions upholding the Commission in increasing the sanctions imposed by the hearing examiner. This action has been specifically upheld in Nees v. SEC, 414 F. 2d 211 (9th Cir. 1969); Hanly v. SEC, 415 F. 2d 589 (2d Cir. 1969); Fink v. SEC, 417 F. 2d 1058 (2d Cir. 1969); Gross v. SEC, 418 F. 2d 1058 (2d Cir. 1969)."

Petitioners' arguments that they were "punished" for litigating the proceeding and that the record was so "stale" that they should

80/ The hearing examiner concluded that Registrant should be suspended for four months from the Philadelphia-Baltimore-Washington Stock Exchange and the National Association of Securities Dealers; that Hodgdon, Haight, Adam and Harper should be barred; and that lesser sanctions be imposed on Carr, Kitain, Davis and Kibler.

81/ Petitioners appear to believe that the Commission could not increase the sanctions imposed by the hearing examiner because it did not sustain all of his findings of violations (Br. 68-69). This is analogous to arguing that a man who is charged with having murdered ten people must be allowed to go free or be given a light sentence when he is found to have murdered but nine. Petitioners' violations clearly fall into the category of "overkill;" in the aggregate they compelled nothing less than the sanction imposed by the Commission.

simply have been given no sanctions are equally without merit. In response to a contention by petitioners (which they do not make in this Court) that the sanctions imposed on them should be similar to certain cited cases which they claimed involved similar violations, the Commission, while rejecting this contention, noted that some of the cases referred to involved settlements. Since in such cases the respondents do not admit violations and the Commission does not make findings based upon an administrative record,^{82/} the Commission noted that it may give consideration to the time and effort saved by the agency in its determination of what sanction is appropriate. However, in evaluating the factors relevant to a determination of the appropriate level of sanctions in this case, the Commission gave no consideration to the vigor with which petitioners defended themselves or the amount of time consumed by the proceedings. There is not a scintilla of proof in the record of this case to suggest that petitioners were penalized or punished for litigating,^{83/}

^{82/} The findings in such cases are those to which the respondents have consented for the purpose of settlement without admitting any violations.

^{83/} As in the O'Leary case, supra, 137 U.S. App. D.C. at 422, 424 F. 2d at 910, petitioners apparently seek "to illustrate the principle that while in most cases the Commission's remedial action is very human and sometimes superhuman, it was, in the present case, inhuman." It would be ironic indeed if the Commission's asserted leniency in settlement cases were to become grounds for voiding its careful and deliberative determinations in litigated proceedings.

Apart from the fact that the cases cited by petitioners on page 67 of their brief involve criminal proceedings, to which significantly different principles apply, in each of those cases there was a basis in the record for a finding that the defendant had been the subject of "vindictive" sentencing.

nor is there any basis for asserting that the sanctions imposed were not fully appropriate in light of the findings of repeated and sustained securities violations of the most flagrant nature.

Although the misconduct on which the sanctions were based occurred between 1960 and 1964, the administrative investigation of Registrant's affairs--including its method of operation, transactions with customers, transactions in particular securities, and books and records--required considerable efforts on the part of the Commission's heavily burdened enforcement staff. The proceedings did not begin until 1966 and, after preliminary procedural motions had been disposed of, the hearings were promptly commenced. The time between the commencement of hearings and the initial decision of the hearing examiner was less than three years, including the time required by the examiner to examine a record of over 13,000 pages and 1,100 exhibits and to make findings of fact and conclusions of law. Additional time was required for the Commission itself to make an independent review of the record and to make appropriate findings. Considering the fact that there were five sets of counsel involved, including staff counsel, and considering the complexity of the issues of fact and law and the amount of evidence adduced, it would be difficult to conclude that the proceedings could have been conducted with significantly greater expedition.^{84/} Petitioners remained in business throughout the proceedings.

Although the Commission is acutely concerned that possible securities violations be detected as soon as possible after they

^{84/} As often occurs in such proceedings, counsel made numerous requests for adjournment both for the purpose of preparing their cases and in order to meet pressing commitments in other cases.

have occurred and that proceedings brought for the purpose of determining whether violations have occurred be concluded promptly, it is inevitable that there will from time to time be proceedings that are by their nature protracted. The problem in petitioners' case was not, as they assert, that the record was "stale," but that the protracted nature of the proceedings delayed the time when the Commission could evaluate their wrongdoing and impose appropriate sanctions. As the Commission pointed out (Op. 27, JA 336):

"The imposition of sanctions here is no less remedial because of the lapse of time since the misconduct occurred. [Petitioners'] argument would in effect require the dismissal of broker-dealer proceedings in any case where an extensive investigation was made, a large number of respondents were involved and the many issues raised were vigorously litigated."

The Commission did consider the "measures adopted by registrant to prevent a recurrence of the alleged violations"; it weighed the other mitigative factors put forward by petitioners; it knew full well the potential impact of its determination. But it also was confronted with a series of willful securities violations that could not be attributed to mere oversight or inadvertence; the record seethed with overwhelming evidence of callous indifference to the rights and interests of public investors, to the duties and obligations of members of the securities industry who hold themselves out as professional financial counsellors, to the dictates of the

Congress and the Commission. The only remedy considered appropriate by the Commission under circumstances such as these, the only way in which the protection of public investors could be ensured and the public interest vindicated was the revocation of Registrant's broker-dealer registration, its expulsion from the self-regulatory organizations and the barring of individual petitioners from association with any broker or dealer. These sanctions, which will clearly prevent petitioners from committing future violations as members of the securities industry, were not only well within the Commission's discretion, but eminently just.

CONCLUSION

For the foregoing reasons the orders of the Commission should be affirmed.

Respectfully submitted,

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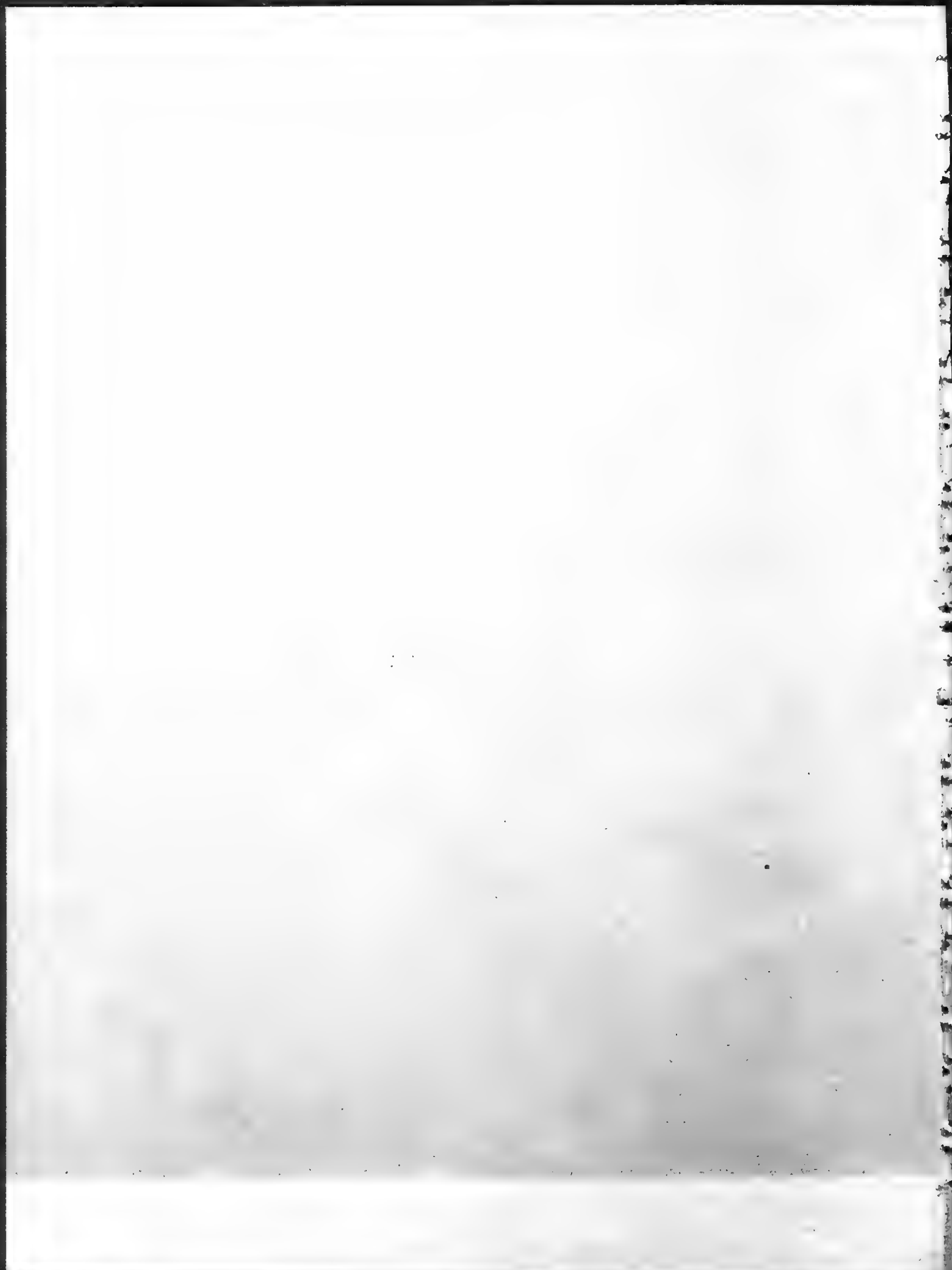
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STATUTORY APPENDIX



Administrative Procedure Act

Section 5(a), (c), 5 U.S.C.
554(a), (c):

ADJUDICATION

Sec. 5. In every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing, except to the extent that there is involved (1) any matter subject to a subsequent trial of the law and the facts de novo in any court; (2) the selection or tenure of an officer or employee of the United States other than examiners appointed pursuant to section 11; (3) proceedings in which decisions rest solely on inspections, tests, or elections; (4) the conduct of military, naval, or foreign affairs functions; (5) cases in which an agency is acting as an agent for a court; and (6) the certification of employee representatives—

(a) *Notice.*—Persons entitled to notice of an agency hearing shall be timely informed of (1) the time, place, and nature thereof; (2) the legal authority and jurisdiction under which the hearing is to be held; and (3) the matters of fact and law asserted. In instances in which private persons are the moving parties, other parties to the proceeding shall give prompt notice of issues controverted in fact or law; and in other instances agencies may by rule require responsive pleading. In fixing the times and places for hearings, due regard shall be had for the convenience and necessity of the parties or their representatives.

(c) *Separation of Functions.*—The same officers who preside at the reception of evidence pursuant to section 7 shall make the recommended decision or initial decision required by section 8 except where such officers become unavailable to the agency. Save to the extent required for the disposition of ex parte matters as authorized by law, no such officer shall consult any person or party on any fact in issue unless upon notice and opportunity for all parties to participate; nor shall such officer be responsible to or subject to the supervision or direction of any officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency. No officer, employee, or agent engaged in the performance of investigative or prosecuting functions for any agency in any case shall, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review pursuant to section 8 except as witness or counsel in public proceedings. This subsection shall not apply in determining applications for initial licenses or to proceedings involving the validity or application of rates, facilities, or practices of public utilities or carriers; nor shall it be applicable in any manner to the agency or any member or members of the body comprising the agency.

Administrative Procedure Act (continued)

Section 7(a), 5 U.S.C. 556(a):

HEARINGS

Sec. 7. In hearings which section 4 or 5 requires to be conducted pursuant to this section—

(a) *Presiding Officers.*—There shall preside at the taking of evidence (1) the agency, (2) one or more members of the body which comprises the agency, or (3) one or more examiners appointed as provided in this Act; but nothing in this Act shall be deemed to supersede the conduct of specified classes of proceedings in whole or part by or before boards or other officers specially provided for by or designated pursuant to statute. The functions of all presiding officers and of officers participating in decisions in conformity with section 8 shall be conducted in an impartial manner. Any such officer may at any time withdraw if he deems himself disqualified; and, upon the filing in good faith of a timely and sufficient affidavit of personal bias or disqualification of any such officer, the agency shall determine the matter as a part of the record and decision in the case.

Administrative Procedure Act (continued)

Section 8(b), 5 U.S.C.
557(b):

DECISIONS

Sec. 8. In cases in which a hearing is required to be conducted in conformity with section 7—

* * *

(b) *Submittals and Decisions.*—Prior to each recommended, initial, or tentative decision, or decision upon agency review of the decision of subordinate officers the parties shall be afforded a reasonable opportunity to submit for the consideration of the officers participating in such decisions (1) proposed findings and conclusions, or (2) exceptions to the decisions or recommended decisions of subordinate officers or to tentative agency decisions, and (3) supporting reasons for such exceptions or proposed findings or conclusions. The record shall show the ruling upon each such finding, conclusion, or exception presented. All decisions (including initial, recommended, or tentative decisions) shall become a part of the record and include a statement of (1) findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record; and (2) the appropriate rule, order, sanction, relief, or denial thereof.

Section 10(e), 5 U.S.C.
706(e):

JUDICIAL REVIEW

Sec. 10. Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—

* * *

(e) *Scope of Review.*—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall (A) compel agency action unlawfully withheld or unreasonably delayed; and (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; (2) contrary to constitutional right, power, privilege, or immunity; (3) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right; (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided by statute; or (6) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court. In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party, and due account shall be taken of the rule of prejudicial error.

Securities Act of 1933

Section 5(a), (c), 15 U.S.C.
77e(a), (c):

**Prohibitions Relating to Interstate Commerce
and the Mails**

SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise;⁴ or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

* * *

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.⁵

Section 4, 15 U.S.C.
77d:

Exempted Transactions

SEC. 4. The provisions of section 5 shall not apply to—

(1) transactions by any person other than an issuer, underwriter, or dealer.

(2) transactions by an issuer not involving any public offering.

Section 17(a), 15 U.S.C. 77q(a):

Fraudulent Interstate Transactions

SEC. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Section 19(a), 15 U.S.C. 77s(a):

Special Powers of Commission

SEC. 19. (a) The Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this title, including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this title. Among other things, the Commission shall have authority, for the purposes of this title, to prescribe the form

Securities Act of 1933 (continued)

Section 19(a), 15 U.S.C. 77s(a):

or forms in which required information shall be set forth, the items or details to be shown in the balance sheet and earning statement, and the methods to be followed in the preparation of accounts, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer; but insofar as they relate to any common carrier subject to the provisions of section 20 of the Interstate Commerce Act, as amended, the rules and regulations of the Commission with respect to accounts shall not be inconsistent with the requirements imposed by the Interstate Commerce Commission under authority of such section 20. The rules and regulations of the Commission shall be effective upon publication in the manner which the Commission shall prescribe. No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.¹

Securities Exchange Act of 1934

Section 10(b), 15 U.S.C. 78j(b):

**Regulation of the Use of Manipulative and
Deceptive Devices**

Section 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Exchange Act of 1934 (continued)
Section 15(b), 15 U.S.C. 78o(b):

(b) (1) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to

such broker or dealer and any persons associated with such broker or dealer as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

(2) An application for registration of a broker or dealer to be formed or organized may be made by a broker or dealer to which the broker or dealer to be formed or organized is to be the successor. Such application shall contain such information in such detail as to the applicant and as to the successor and any person associated with the applicant or the successor, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine. Such registration shall terminate on the forty-fifth day after the effective date thereof, unless prior thereto the successor shall, in accordance with such rules and regulations as the Commission may prescribe, adopt such application as its own.

(3) If any amendment to any application for registration pursuant to this subsection is filed prior to the effective date of the registration, such amendment shall be deemed to have been filed simultaneously with and as part of such application; except that the Commission may, if it appears necessary or appropriate in the public interest or for the protection of investors, defer the effective date of any such registration as thus amended until the thirtieth day after the filing of such amendment.

(4) Any provision of this title (other than section 5 and subsection (a) of this section) which prohibits any act, practice, or course of business if the mails or any means or instrumentality of interstate commerce are used in connection therewith shall also prohibit any such act, practice, or course of business by any broker or dealer registered pursuant to this subsection or any person acting on behalf of such a broker or dealer, irrespective of any use of the mails or any means or

Securities Exchange Act of 1934 (continued)
Section 15(b), 15 U.S.C. 78o(b):

instrumentality of interstate commerce in connection therewith.

(5) The Commission shall, after appropriate notice and opportunity for hearing, by order censure, deny registration to, suspend for a period not exceeding twelve months, or revoke the registration of, any broker or dealer if it finds that such censure, denial, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated—

(A) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this title, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein.

(B) has been convicted within ten years preceding the filing of the application or at any time thereafter of any felony or misdemeanor which the Commission finds—

(i) involves the purchase or sale of any security.

(ii) arises out of the conduct of the business of a broker, dealer, or investment adviser.

(iii) involves embezzlement, fraudulent conversion, or misappropriation of funds or securities.

(iv) involves the violation of section 1341, 1342, or 1343 of title 18, United States Code.

(C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, or dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

(D) has willfully violated any provision of the Securities Act of 1933, or of the Investment

Securities Exchange Act of 1934 (continued)
Section 15(b), 15 U.S.C. 78o(b):

Advisers Act of 1940, or of the Investment Company Act of 1940, or of this title, or of any rule or regulation under any of such statutes.

(E) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of the Securities Act of 1933, or the Investment Advisers Act of 1940, or the Investment Company Act of 1940, or of this title, or of any rule or regulation under any of such statutes or has failed reasonably to supervise, with a view to preventing violations of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this clause (E) no person shall be deemed to have failed reasonably to supervise any person, if—

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

(F) is subject to an order of the Commission entered pursuant to paragraph (7) of this subsection (b) barring or suspending the right of such person to be associated with a broker or dealer, which order is in effect with respect to such person.

(6) Pending final determination whether any registration under this subsection shall be denied, the Commission may by order postpone the effective date of such registration for a period not to exceed fifteen days, but if, after appropriate notice and opportunity for hearing (which may consist solely of affidavits and oral arguments), it shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors to postpone the effective date of such registration until final determination, the Commission shall so order. Pending final determination whether any such registration shall be revoked, the Commission shall by order suspend such registration if, after appropriate notice and

opportunity for hearing, such suspension shall appear to the Commission to be necessary or appropriate in the public interest or for the protection of investors. Any registered broker or dealer may, upon such terms and conditions as the Commission may deem necessary in the public interest or for the protection of investors, withdraw from registration by filing a written notice of withdrawal with the Commission. If the Commission finds that any registered broker or dealer, or any broker or dealer for whom an application for registration is pending, is no longer in existence or has ceased to do business as a broker or dealer, the Commission shall by order cancel the registration or application of such broker or dealer.

(7) The Commission may, after appropriate notice and opportunity for hearing, by order censure any person, or bar or suspend for a period not exceeding twelve months any person from being associated with a broker or dealer, if the Commission finds that such censure, barring, or suspension is in the public interest and that such person has committed or omitted any act or omission enumerated in clause (A), (D) or (E) of paragraph (5) of this subsection or has been convicted of any offense specified in clause (B) of said paragraph (5) within ten years of the commencement of the proceedings under this paragraph or is enjoined from any action, conduct, or practice specified in clause (C) of said paragraph (5). It shall be unlawful for any person as to whom such an order barring or suspending him from being associated with a broker or dealer is in effect, willfully to become, or to be, associated with a broker or dealer, without the consent of the Commission, and it shall be unlawful for any broker or dealer to permit such a person to become, or remain, a person associated with him, without the consent of the Commission, if such broker or dealer knew, or in the exercise of reasonable care, should have known, of such order.

(8) No broker or dealer registered under section 15 of this title shall, during any period when it is not a member of a securities association registered with the Commission under section 15A of this title, effect any transaction in, or induce the purchase or sale of, any security (otherwise than on a national securities exchange) unless such broker or dealer and all natural persons associated with such broker or dealer meet such specified and ap-

Securities Exchange Act of 1934 (continued)
Section 15(b), 15 U.S.C. 78o(b):

appropriate standards with respect to training, experience, and such other qualifications as the Commission finds necessary or desirable. The Commission shall establish such standards by rules and regulations, which may—

(A) appropriately classify brokers and dealers and persons associated with brokers and dealers (taking into account relevant matters, including types of business done and nature of securities sold).

(B) specify that all or any portion of such standards shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules and regulations.

(D) provide that persons in any such class other than a broker or a dealer and partners, officers, and supervisory employees (which latter term may be defined by the Commission's rules and regulations and as so defined shall include branch managers of brokers or dealers) of brokers or dealers, may be qualified solely on the basis of compliance with such specified standards of training and such other qualifications as the Commission finds appropriate.

The Commission may prescribe by rules and regulations reasonable fees and charges to defray its costs in carrying out this paragraph, including, but not limited to, fees for any examination administered by it, or under its direction. The Commission may cooperate with securities associations registered under section 15A of this title and with national securities exchanges in administering examinations and may require brokers and dealers subject to this paragraph and persons associated with such brokers and dealers to pass examinations administered by or on behalf of any such association or exchange and to pay to such association or exchange reasonable fees or charges to defray the costs incurred by such association or exchange in administering such examinations.

(9) In addition to the fees and charges authorized by paragraph (8), each broker or dealer registered under section 15 of this title not a member of a securities association registered pursuant to section 15A of this title shall pay to the Commission such reasonable fees and charges as may be necessary to defray the costs of additional regulatory duties required to be performed by the Commission because such broker or dealer is not a

member of such a securities association. The Commission shall establish such fees and charges by rules and regulations.

(10) No broker or dealer subject to paragraph (8) of this subsection shall effect any transaction in, or induce the purchase or sale of, any security (otherwise than on a national securities exchange) in contravention of such rules and regulations as the Commission may prescribe designed to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and in general to protect investors and the public interest, and to remove impediments to and perfect the mechanism of a free and open market.¹

Securities Exchange Act of 1934 (continued)
Section 15(c), 15 U.S.C. 78o(c):

(c)(1) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, by means of any manipulative, deceptive, or other fraudulent device or contrivance. The Commission shall, for the purposes of this subsection, by rules and regulations define such devices or contrivances as are manipulative, deceptive, or otherwise fraudulent.

(2) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, in connection with which such broker or dealer engages in any fraudulent, deceptive, or manipulative act or practice, or makes any fictitious quotation. The Commission shall, for the purposes of this paragraph, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative and such quotations as are fictitious.

(3) No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or com-

Securities Exchange Act of 1934 (continued)
Section 15(c), 15 U.S.C. 78o(c):

mercial bills) otherwise than on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors to provide safeguards with respect to the financial responsibility of brokers and dealers.¹

(4) If the Commission finds, after notice and opportunity for hearing, that any person subject to the provisions of section 12, 13, or subsection (d) of section 15 of this title or any rule or regulation thereunder has failed to comply with any such provision, rule, or regulation in any material respect, the Commission may publish its findings and issue an order requiring such person to comply with such provision or such rule or regulation thereunder upon such terms and conditions and within such time as the Commission may specify in such order.

(5) If in its opinion the public interest and the protection of investors so require, the Commission is authorized summarily to suspend trading, otherwise than on a national securities exchange, in any security (other than an exempted security) for a period not exceeding ten days. No broker or dealer shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security in which trading is so suspended.²

(d) Each issuer which has filed a registration statement containing an undertaking which is or becomes operative under this subsection as in effect prior to the date of enactment of the Securities Acts Amendments of 1964, and each issuer which shall after such date file a registration statement which has become effective pursuant to the Securities Act of 1933, as amended, shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or

for the protection of investors, such supplementary and periodic information, documents, and reports as may be required pursuant to section 13 of this title in respect of a security registered pursuant to section 12 of this title. The duty to file under this subsection shall be automatically suspended if and so long as any issue of securities of such issuer is registered pursuant to section 12 of this title. The duty to file under this subsection shall also be automatically suspended as to any fiscal year, other than the fiscal year within which such registration statement became effective, if, at the beginning of such fiscal year, the securities of each class to which the registration statement relates are held of record by less than three hundred persons. For the purposes of this subsection, the term "class" shall be construed to include all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges. Nothing in this subsection shall apply to securities issued by a foreign government or political subdivision thereof.³

Securities Exchange Act of 1934 (continued)
Section 15A, 15 U.S.C. 78o-3:

SECTION 15A. (a) Any association of brokers or dealers may be registered with the Commission as a national securities association pursuant to subsection (b), or as an affiliated securities association pursuant to subsection (d), under the terms and conditions hereinafter provided in this section, by filing with the Commission a registration statement in such form as the Commission may prescribe, setting forth the information, and accompanied by the documents, below specified:

(1) Such data as to its organization, membership, and rules of procedure, and such other information as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors; and

(2) Copies of its constitution, charter, or articles of incorporation or association, with all amendments thereto, and of its existing bylaws, and of any rules or instruments corresponding to the foregoing, whatever the name, hereinafter in this title collectively referred to as the "rules of the association."

Such registration shall not be construed as a waiver by such association or any member thereof of any constitutional right or of any right to contest the validity of any rule or regulation of the Commission under this title.

(b) An applicant association shall not be registered as a national securities association unless it appears to the Commission that—

(1) by reason of the number of its members, the scope of their transactions, and the geographical distribution of its members such association will be able to comply with the provisions of this title and the rules and regulations thereunder and to carry out the purposes of this section.

(2) such association is so organized and is of such a character as to be able to comply with the provisions of this title and the rules and regulations thereunder, and to carry out the purposes of this section.

(3) the rules of the association provide that any broker or dealer who makes use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, may

become a member of such association, except such as are excluded pursuant to paragraph (4) or (5) of this subsection, or a rule of the association permitted under this paragraph. The rules of the association may restrict membership in such association on such specified geographical basis, or on such specified basis relating to the type of business done by its members, or on such other specified and appropriate basis, as appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purpose of this section. Rules adopted by the association may provide that the association may, unless the Commission directs otherwise in cases in which the Commission finds it appropriate in the public interest so to direct, deny admission to or refuse to continue in such association any broker or dealer if—

(A) such broker or dealer, whether prior or subsequent to becoming such, or

(B) any person associated with such broker or dealer, whether prior or subsequent to becoming so associated,

has been and is suspended or expelled from a national securities exchange or has been and is barred or suspended from being associated with all members of such exchange, for violation of any rule of such exchange.

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if such broker or dealer—

(A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange or has been and is barred or suspended from being associated with all members of such association or from being associated with all brokers or dealers which are members of such exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which consti-

Securities Exchange Act of 1934 (continued)
Section 15A, 15 U.S.C. 78o-3:

tutes conduct inconsistent with just and equitable principles of trade.

(B) is subject to an order of the Commission denying, suspending for a period not exceeding twelve months, or revoking his registration pursuant to section 15 of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or barring or suspending him from being associated with a broker or dealer.

(C) whether prior or subsequent to becoming a broker or dealer, by his conduct while associated with a broker or dealer, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such broker or dealer, and in entering such a suspension, expulsion, or order, the Commission or any such exchange or association shall have jurisdiction to determine whether or not any person was a cause thereof.

(D) has associated with him any person who is known, or in the exercise of reasonable care should be known, to him to be a person who, if such person were a broker or dealer, would be ineligible for admission to or continuance in membership under clause (A), (B), or (C) of this paragraph.

(5) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no person shall become a member and no natural person shall become a person associated with a member, unless such person is qualified to become a member or a person associated with a member in conformity with specified and appropriate standards with respect to the training, experience, and such other qualifications of such person as the association finds necessary or desirable, and in the case of a member, the financial responsibility of such member. For the purpose of defining such standards and the application thereof, such rules may—

(A) appropriately classify prospective members (taking into account relevant matters, including type of business done and nature of securities sold) and persons proposed to be associated with members.

(B) specify that all or any portion of such standards shall be applicable to any such class.

(C) require persons in any such class to pass examinations prescribed in accordance with such rules.

(D) provide that persons in any such class other than prospective members and partners, officers and supervisory employees (which latter term may be defined by such rules and as so defined shall include branch managers of members) of members, may be qualified solely on the basis of compliance with specified standards of training and such other qualifications as the association finds appropriate.

(E) provide that applications to become a member or a person associated with a member shall set forth such facts as the association may prescribe as to the training, experience, and other qualifications (including, in the case of an applicant for membership, financial responsibility) of the applicant and that the association may adopt procedures for verification of qualifications of the applicant.

(F) require any class of persons associated with a member to be registered with the association in accordance with procedures specified by such rules (and any application or document supplemental thereto required by such rules of a person seeking to be registered with such association shall, for the purposes of subsection (a) of section 32 of this title, be deemed an application required to be filed under this title).

(6) the rules of the association assure a fair representation of its members in the adoption of any rule of the association or amendment thereto, the selection of its officers and directors, and in all other phases of the administration of its affairs.

(7) the rules of the association provide for the equitable allocation of dues among its members, to defray reasonable expenses of administration.

(8) the rules of the association are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to provide safeguards against unreasonable profits or unreasonable rates of commissions or other charges, and, in general, to protect investors and the public in-

Securities Exchange Act of 1934 (continued)
Section 15A, 15 U.S.C. 78o-3:

terest, and to remove impediments to and perfect the mechanism of a free and open market; and are not designed to permit unfair discrimination between customers or issuers, or brokers or dealers, to fix minimum profits, to impose any schedule of prices, or to impose any schedule or fix minimum rates of commissions, allowances, discounts, or other charges.

(9) the rules of the association provide that its members and persons associated with its members shall be appropriately disciplined, by expulsion, suspension, fine, censure, or being suspended or barred from being associated with all members, or any other fitting penalty, for any violation of its rules.

(10) the rules of the association provide a fair and orderly procedure with respect to the disciplining of members and persons associated with members and the denial of membership to any broker or dealer seeking membership therein or the barring of any person from being associated with a member. In any proceeding to determine whether any member or other person shall be disciplined, such rules shall require that specific charges be brought; that such member or person shall be notified of, and be given an opportunity to defend against, such charges; that a record shall be kept; and that the determination shall include—

(A) a statement setting forth any act or practice in which such member or other person may be found to have engaged, or which such member or other person may be found to have omitted.

(B) a statement setting forth the specific rule or rules of the association of which any such act or practice, or omission to act, is deemed to be in violation.

(C) a statement whether the acts or practices prohibited by such rule or rules, or the omission of any act required thereby, are deemed to constitute conduct inconsistent with just and equitable principles of trade.

(D) a statement setting forth the penalty imposed.

In any proceeding to determine whether a broker or dealer shall be denied membership or whether any person shall be barred from being associated with a member, such rules shall provide that the broker or dealer or person shall

be notified of, and be given an opportunity to be heard upon, the specific grounds for denial or bar which are under consideration; that a record shall be kept; and that the determination shall set forth the specific grounds upon which the denial or bar is based.

(11) the requirements of subsection (c), insofar as these may be applicable, are satisfied.

(12) the rules of the association include provisions governing the form and content of quotations relating to securities sold otherwise than on a national securities exchange which may be disseminated by any member or any person associated with a member, and the persons to whom such quotations may be supplied. Such rules relating to quotations shall be designed to produce fair and informative quotations, both at the wholesale and retail level, to prevent fictitious or misleading quotations, and to promote orderly procedures for collecting and publishing quotations.

The provisions of this subsection, as in effect prior to the date of enactment of the Securities Acts Amendments of 1964, shall be applicable to the rules of any registered securities association which was registered on such date until July 1, 1964. After July 1, 1964, the Commission may, after notice and opportunity for hearing, suspend the registration of any such association if it finds that the rules thereof do not conform to the requirements of this subsection, as amended by section 7 of the Securities Acts Amendments of 1964, and any such suspension shall remain in effect until the Commission issues an order determining that such rules have been modified to conform with such requirements.²

(c) The Commission may permit or require the rules of an association applying for registration pursuant to subsection (b), to provide for the admission of an association registered as an affiliated securities association, pursuant to subsection (d), to participation in said applicant association as an affiliate thereof, under terms permitting such power and responsibilities to such affiliates, and under such other appropriate terms and conditions, as may be provided by the rules of said applicant association, if such rules appear to the

Securities Exchange Act of 1934 (continued)
Section 15A, 15 U.S.C. 78q-3:

Commission to be necessary or appropriate in the public interest or for the protection of investors and to carry out the purposes of this section. The duties and powers of the Commission with respect to any national securities association or any affiliated securities association shall in no way be limited by reason of any such affiliation.

(d) An applicant association shall not be registered as an affiliated securities association unless it appears to the Commission that—

(1) such association, notwithstanding that it does not satisfy the requirements set forth in paragraph (1) of subsection (b), will, forthwith upon the registration thereof, be admitted to affiliation with an association registered as a national securities association pursuant to said subsection (b), in the manner and under the terms and conditions provided by the rules of said national securities association in accordance with subsection (c); and

(2) such association and its rules satisfy the requirements set forth in paragraphs (2) to (10), inclusive, and paragraph (12), of subsection (b); except that in the case of any such association any restrictions upon membership therein of the type authorized by paragraph (3) of subsection (b) shall not be less stringent than in the case of the national securities association with which such association is to be affiliated.¹

(e) Upon the filing of an application for registration pursuant to subsection (b) or subsection (d), the Commission shall by order grant such registration if the requirements of this section are satisfied. If, after appropriate notice and opportunity for hearing, it appears to the Commission that any requirement of this section is not satisfied, the Commission shall by order deny such registration. If any association granted registration as an affiliated securities association pursuant to subsection (d) shall fail to be admitted promptly thereafter to affiliation with a registered national securities association, the Commission shall revoke the registration of such affiliated securities association.

(f) A registered securities association (whether national or affiliated) may, upon such reasonable notice as the Commission may deem necessary in the public interest or for the protection of inves-

tors, withdraw from registration by filing with the Commission a written notice of withdrawal in such form as the Commission may by rules and regulations prescribe. Upon the withdrawal of a national securities association from registration, the registration of any association affiliated therewith shall automatically terminate.

(g) If any registered securities association (whether national or affiliated) takes any disciplinary action against any member thereof or any person associated with such a member or denies admission to any broker or dealer seeking membership therein, or bars any person from being associated with a member, such action shall be subject to review by the Commission, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after such action has been taken or within such longer period as the Commission may determine. Application to the Commission for review, or the institution of review by the Commission on its own motion, shall operate as a stay of such action until an order is issued upon such review pursuant to subsection (h), unless the Commission otherwise orders after notice and opportunity for hearing on the question of a stay (which hearing may consist solely of affidavits and oral arguments).²

(h) (1) In a proceeding to review disciplinary action taken by a registered securities association against a member thereof or a person associated with a member, if the Commission, after appropriate notice and opportunity for hearing, upon consideration of the record before the association and such other evidence as it may deem relevant—

(A) finds that such member or person has engaged in such acts or practices, or has omitted such act, as the association has found him to have engaged in or omitted, and

(B) determines that such acts or practices, or omission to act, are in violation of such rules of the association as have been designated in the determination of the association,

the Commission shall by order dismiss the proceeding, unless it appears to the Commission that such action should be modified in accordance with paragraph (2) of this subsection. The Commission shall likewise determine whether the acts or practices prohibited, or the omission of any act required, by

Securities Exchange Act of 1934 (continued)
Section 15A, 15 U.S.C. 78o-3:

any such rule constitute conduct inconsistent with just and equitable principles of trade, and shall so declare. If it appears to the Commission that the evidence does not warrant the finding required in clause (A), or if the Commission determines that such acts or practices as are found to have been engaged in are not prohibited by the designated rule or rules of the association, or that such act as is found to have been omitted is not required by such designated rule or rules, the Commission shall by order set aside the action of the association.

(2) If, after appropriate notice and opportunity for hearing, the Commission finds that any penalty imposed upon a member or person associated with a member is excessive or oppressive, having due regard to the public interest, the Commission shall by order cancel, reduce, or require the remission of such penalty.

(3) In any proceeding to review the denial of membership in a registered securities association or the barring of any person from being associated with a member, if the Commission, after appropriate notice and hearing, and upon consideration of the record before the association and such other evidence as it may deem relevant, determines that the specific grounds on which such denial or bar is based exist in fact and are valid under this section, the Commission shall by order dismiss the proceeding; otherwise, the Commission shall by order set aside the action of the association and require it to admit the applicant broker or dealer to membership therein, or to permit such person to be associated with a member.¹

(i) (1) The rules of a registered securities association may provide that no member thereof shall deal with any nonmember broker or dealer (as defined in paragraph (2) of this subsection) except at the same prices, for the same commissions or fees, and on the same terms and conditions as are by such member accorded to the general public.

(2) For the purposes of this subsection, the term "nonmember broker or dealer" shall include any broker or dealer who makes use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security otherwise than on a national securities exchange, who is not a member of any registered securities association,

except a broker or dealer who deals exclusively in commercial paper, bankers' acceptances, or commercial bills.

(3) Nothing in this subsection shall be so construed or applied as to prevent any member of a registered securities association from granting to any other member of any registered securities association any dealer's discount, allowance, commission, or special terms.

(j) Every registered securities association shall file with the Commission in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, copies of any changes in or additions to the rules of the association, and such other information and documents as the Commission may require to keep current or to supplement the registration statement and documents filed pursuant to subsection (a). Any change in or addition to the rules of a registered securities association shall take effect upon the thirtieth day after the filing of a copy thereof with the Commission, or upon such earlier date as the Commission may determine, unless the Commission shall enter an order disapproving such change or addition; and the Commission shall enter such an order unless such change or addition appears to the Commission to be consistent with the requirements of subsection (b) and subsection (d).

(k) (1) The Commission is authorized by order to abrogate any rule of a registered securities association, if after appropriate notice and opportunity for hearing, it appears to the Commission that such abrogation is necessary or appropriate to assure fair dealing by the members of such association, to assure a fair representation of its members in the administration of its affairs or otherwise to protect investors or effectuate the purposes of this title.

(2) The Commission may in writing request any registered securities association to adopt any specified alteration of or supplement to its rules with respect to any of the matters hereinafter enumerated. If such association fails to adopt such alteration or supplement within a reasonable time, the Commission is authorized by order to alter or supplement the rules of such association in the manner theretofore requested, or with such modifications of such alteration or supplement as it

Securities Exchange Act of 1934 (continued)
Section 15A, 15 U.S.C. 78g-3:

deems necessary if, after appropriate notice and opportunity for hearing, it appears to the Commission that such alteration or supplement is necessary or appropriate in the public interest or for the protection of investors or to effectuate the purposes of this section, with respect to—

(A) the basis for, and procedure in connection with, the denial of membership or the barring from being associated with a member or the disciplining of members or persons associated with members, or the qualifications required for members or natural persons associated with members or any class thereof.

(B) the method for adoption of any change in or addition to the rules of the association.

(C) the method of choosing officers and directors.

(D) affiliation between registered securities associations.¹

(2) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

(1) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to revoke the registration of a registered securities association, if the Commission finds that such association has violated any provision of this title or any rule or regulation thereunder, or has failed to enforce compliance with its own rules, or has engaged in any other activity tending to defeat the purposes of this section.

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a registered securities association any member thereof, or to suspend for a period not exceeding twelve months or to bar any person from being associated with a member thereof, if the Commission finds that such member or person—

(A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provi-

sion of this title or any rule or regulation thereunder.

(B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule or regulation.

(3) after appropriate notice and opportunity for hearing, by order to remove from office any officer or director of a registered securities association who, the Commission finds, has willfully failed to enforce the rules of the association, or has willfully abused his authority.²

(m) Nothing in this section shall be construed to apply with respect to any transaction by a broker or dealer in any exempted security.

(n) If any provision of this section is in conflict with any provision of any law of the United States in force on the date this section takes effect, the provision of this section shall prevail.³

Securities Exchange Act of 1934
(continued)

Section 19(a), 15 U.S.C.
78s(a):

Section 17(a), 15 U.S.C. 78q(a):

**Accounts and Records, Reports, Examinations
of Exchanges, Members, and Others**

SECTION 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association,¹ and every broker or dealer registered pursuant to section 15 of this title,² shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

**Powers With Respect to Exchanges and
Securities**

SECTION 19. (a) The Commission is authorized, if in its opinion such action is necessary or appropriate for the protection of investors—

(1) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to withdraw the registration of a national securities exchange if the Commission finds that such exchange has violated any provision of this title or of the rules and regulations thereunder or has failed to enforce, so far as is within its power, compliance therewith by a member or by an issuer of a security registered thereon.

(2) After appropriate notice and opportunity for hearing, by order to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to withdraw, the registration of a security if the Commission finds that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder.

(3) After appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding twelve months or to expel from a national securities exchange any member or officer thereof whom the Commission finds has violated any provision of this title or the rules and regulations thereunder, or has affected any transaction for any other person who, he has reason to believe, is violating in respect of such transaction any provision of this title or the rules and regulations thereunder.

(4) And if in its opinion the public interest so requires, summarily to suspend trading in any registered security on any national securities exchange for a period not exceeding ten days, or with the approval of the President, summarily to suspend all trading on any national securities exchange for a period not exceeding ninety days.

Securities Exchange Act of 1934
(continued)

Section 19(d), 15 U.S.C.
78s(d):

(d) The Commission is authorized and directed to make a study and investigation of the adequacy, for the protection of investors, of the rules of national securities exchanges and national securities associations, including rules for the expulsion, suspension, or disciplining of a member for conduct inconsistent with just and equitable principles of trade. The Commission shall report to the Congress on or before April 3, 1963, the results of its study and investigation, together with its recommendations, including such recommendations for legislation as it deems advisable. The Commission is authorized to appoint, without regard to the civil service laws, rules and regulations, such personnel as the Commission deems advisable to carry out such study and investigation and to fix their respective rates of compensation without regard to the Classification Act of 1949, as amended, but no such rate shall exceed \$18,500 per annum. To carry out such study and investigation there is hereby authorized to be appropriated the sum of \$950,000.¹

Section 22, 15 U.S.C. 78v:

Hearings by Commission

SECTION 22. Hearings may be public and may be held before the Commission, any member or members thereof, or any officer or officers of the Commission designated by it, and appropriate records thereof shall be kept.

Securities Exchange Act of 1934 (continued)Section 25(a), 15 U.S.C. 78y(a):Court Review of Orders

SECTION 25. (a) Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or set-

ting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).

Rules Under the Securities Exchange Act of 1934

Rule 10b-5, 17 CFR 240.10b-5:

Rule 10b-5. Employment of Manipulative and Deceptive Devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Rules Under the Securities Exchange Act of 1934
(continued)

Rule 15b3-1, 17 CFR
240.15b3-1:

Rule 15b3-1. Amendments to Applications

(a) Every broker or dealer whose registration is effective, or whose application for registration is pending on September 1, 1968, shall file as an amendment to the application a complete Form BD as revised as of September 1, 1968. This shall be filed the first time an amendment is required to be filed under paragraph (b) of this rule, but in no event later than December 31, 1968.

(b) If the information contained in any application for registration as a broker or dealer, or in any amendment thereto, becomes inaccurate for any reason, the broker or dealer shall promptly file an amendment on Form BD correcting such information.

(c) Every amendment filed pursuant to this rule shall constitute a "report" within the meaning of sections 15(b), 17(a), and 32(a) of the Act.

Rule 15c1-2, 17 CFR
240.15c1-2:

Rule 15c1-2. Fraud and Misrepresentation

(a) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15(c)(1) of the Act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(b) The term "manipulative, deceptive or other fraudulent device or contrivance," as used in section 15(c)(1) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(c) The scope of this rule shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to section 15(c)(1) of the Act.

Rule 15c2-4, 17 CFR
240.15c2-4:

Rule 15c2-4. Transmission or Maintenance of Payments Received in Connection With Underwritings

(a) It shall constitute a "fraudulent, deceptive or manipulative act or practice" as used in section 15(c)(2) of the Act, for any broker or dealer participating in any distribution of securities, other than a firm-commitment underwriting, to accept any part of the sale price of any security being distributed unless:

(1) The money or other consideration received is promptly transmitted to the persons entitled thereto; or

(2) If the distribution is being made on an "all-or-none" basis, or on any other basis which contemplates that payment is not to be made to the person on whose behalf the distribution is being made until some further event or contingency occurs, (A) the money or other consideration received is promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interests therein, until the appropriate event or contingency has occurred, and then the funds are promptly transmitted or returned to the persons entitled thereto, or (B) all such funds are promptly transmitted to a bank which has agreed in writing to hold all such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred.

Rules Under the Securities Exchange Act of 1934
(continued)

Rule 17a-3, 17 CFR
240.17a-3:

Rule 17a-3. Records To Be Made by Certain Exchange Members, Brokers, and Dealers

(a) Every member of a national securities exchange who transacts a business in securities directly with others than members of a national securities exchange, and every broker or dealer who transacts a business in securities through the medium of any such member, and every broker or dealer registered pursuant to section 15 of the Securities Exchange Act of 1934, as amended, shall make and keep current the following books and records relating to his business:

(1) Blotters (or other records of original entry) containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records shall show the account for which each such transaction was effected, the name and amount of securities, the unit and aggregate purchase or sale price (if any), the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered.

(2) Ledgers (or other records) reflecting all assets and liabilities, income and expense and capital accounts.

(3) Ledger accounts (or other records) itemizing separately as to each cash and margin account of every customer and of such member, broker or dealer and partners thereof, all purchases, sales, receipts, and deliveries of securities and commodities for such account and all other debits and credits to such account.

(4) Ledgers (or other records) reflecting the following:

- (A) Securities in transfer;
- (B) Dividends and interest received;
- (C) Securities borrowed and securities loaned;
- (D) Monies borrowed and monies loaned (together with a record of the collateral therefor and any substitutions in such collateral);

(E) Securities failed to receive and failed to deliver.

(5) A securities record or ledger reflecting separately for each security as of the clearance dates all "long" or "short" positions (including securities in safekeeping) carried by such member, broker, or dealer for his account or for the account of his customers or partners and showing the location of all securities long and the offsetting position in all securities short and in all cases the name or designation of the account in which each position is carried.

(6) A memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. Such memorandum shall show the terms and conditions of the order or instructions and of any modification or cancellation thereof, the account for which entered, the time of entry, the price at which executed and, to the extent feasible, the time of execution or cancellation. Orders entered pursuant to the exercise of discretionary power by such member, broker, or dealer, or any employee thereof, shall be so designated. The term "instruction" shall be deemed to include instructions between partners and employees of a member, broker, or dealer. The term "time of entry" shall be deemed to mean the time when such member, broker, or dealer transmits the order or instruction for execution or, if it is not so transmitted, the time when it is received.

(7) A memorandum of each purchase and sale of securities for the account of such member, broker, or dealer showing the price and, to the extent feasible, the time of execution; and, in addition, where such purchase or sale is with a customer other than a broker or dealer, a memorandum of each order received, showing the time of receipt, the terms and conditions of the order, and the account in which it was entered.

(8) Copies of confirmations of all purchases and sales of securities and copies of notices of all other debits and credits for securities, cash, and other items for the account of customers and partners of such member, broker, or dealer.

Rules of Practice of the Securities and Exchange Commission

Rule 21(d), 17 CFR 201.21(d)

HEARING BEFORE THE COMMISSION

(d) Leave to adduce additional evidence.

The Commission, upon its own motion or upon application in writing by any party for leave to adduce additional evidence which application shall show to the satisfaction of the Commission that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence at the hearing before the Commission or the hearing officer, may hear such additional evidence or may refer the proceeding to the hearing officer for the taking of such additional evidence.

19-2-3

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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos. 23,244, 23,246, 71-1136
(Consolidated)

HAIGHT & CO., INC.,
A. DANA HODGDON,
JAMES F. HAIGHT,
BURTON KITAIN,
W. LYLES CARR, JR.,
JAMES W. HARPER, III,
DAVID M. ADAM, JR.,
HOMER E. DAVIS, and
ROBERT F. KIBLER,

United States Court of Appeals
for the District of Columbia Circuit

FILED JUN 9 1971

Nathan J. Paulson
CLERK

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for Review of Orders of
the Securities and Exchange Commission

APPENDIX OF THE SECURITIES AND EXCHANGE COMMISSION, RESPONDENT

NOTE: The preparation of Respondent's Appendix was necessitated by the refusal of petitioners' counsel to include in the Joint Appendix any of the record references designated by the Commission. Petitioners' counsel suggested that the Court could refer to the 29 volumes of the transcript if it wished to read the Commission's references. The Commission could not agree to subject the Court to such obvious inconvenience and accordingly reproduced its own appendix.

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General Counsel

WALTER P. NORTH
Associate General Counsel

RICHARD S. SELTZER
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FREDERICK L. WHITE
Attorney

Securities and Exchange
Commission
Washington, D.C. 20549



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Q With whom?

A Mr. Dana Hodgdon / approximately a week before my departure, which was on March 12th, 1932.

Q Would you tell us about that conversation, tell us the details of the conversation?

A / Mr. Hodgdon gave me an ultimatum --

Mr. Shapiro: I'm going to object.

Hearing Examiner Gross: Just tell us what he said.

The Witness: That my cooperation on the underwriting was vital to the interests of the firm, and that he expected me to do my part in the underwriting.

By Mr. Webb:

Q And what did you tell him, sir?

A That I would try, but that I did not like the underwriting. I felt that, inasmuch as the prospectus showed the company to be insolvent, as its current liabilities outweighed its current assets --

Mr. Heller: I object. That is a conclusion.

By Mr. Webb:

Q What did Mr. --

A -- that it was an extremely high risk and therefore, I did not want to sell the underwriting.

Q What happened after this?

A The underwriting had not been going well --

Mr. Shapiro: I'm going to object to that.

Hearing Examiner Gross: Strike.

Just tell us what happened.

The Witness: Upon Monday, --

By Mr. Webb:

Q What happened to you, sir, what happened to you?

A On Monday evening, the 12th of March, I was called in to Mr. Hodgdon's office, --

Q Tell us what he said.

A -- and his words to me were, this was it.

Q Well, what did that mean to you?

A Meaning that I was through, that I hadn't co-operated.

Mr. Shapiro: I'm going to object with regard to anything other than what was said.

Hearing Examiner Gross: Can you tell us what was said?

The Witness: This was fact insofar as I can recollect.

Hearing Examiner Gross: Are you repeating the conversation now?

Mr. Shapiro: He was asked what it meant to him.

Hearing Examiner Gross: Just a minute.

Mr. Shapiro: I'm sorry.

Hearing Examiner Gross: Are you repeating the conversation or your interpretation of it?

The Witness: Only-- No, I repeated Mr. Hodgdon's opening words to me which were, this was it, that I was through.

Hearing Examiner Gross: Was anything further said?

The Witness: Yes.

Hearing Examiner Gross: All right. Continue. Tell us what was said.

The Witness: We discussed the fact that I had not sold VanPak, nor had I sold any real estate syndications. I admitted my lack of enthusiasm for these underwritings and offered to give my notice to resign in two weeks, or whatever he wished.

He said No, that he wanted me to resign as of then. I was out, and that's all.

By Mr. Webb:

Q In other words, you were discharged then?

A Yes.

Q Now prior to your dismissal, Mr. Johns, had you attended any Hodgdon firm sales meetings concerning VanPak Inc. stock, the offering?

A Yes, approximately three meetings, two of which were the regular Tuesday morning meetings.

The second one was a meeting of the associate leaders.

Q Do you recall the approximate value of your securities portfolio in August and September of 1960?

A Approximately \$207,000.

Q \$207,000?

A Approximately.

Q Of that securities portfolio, how much consisted of the stock of Atlantic Research Corporation?

A That I don't recall. Part of it was sold through your company. Part was sold through Sade and Company, and part through Johnston and Lemon.

Q When you said part was sold through my company, I assume you mean part was sold through Hodgdon and Company?

A That's correct.

I have the records if you would care to look at them, and all the dates.

Q Well, let's inquire first:

Do you recall how many shares it was that you held in Atlantic Research as of September 7th, 1960, the day it was shown you purchased \$2200 worth of stock in U. S. Infrared Corporation?

A I don't recall.

Q Would it have been more than 2,000 shares?

A I don't recall.

Q Do you recall the price of Atlantic Research shares at or about September of 1960?

A No.

The exact dates I don't recall. I remember I tried to sell between 62 and 50 as much as I could. There was such a price on earnings that I couldn't afford not to sell, paying a maximum penalty in taxes.

I have the records of my sales of the stock if you would care for it.

Q Well, would you examine your records and tell me how many shares of Atlantic Research you held in September, on September 7th, 1960, if your records show that.

A I have the dates of sales of this stock, but not the number of shares I hold.

Q Did you acquire shares in Atlantic Research after September 7th, 1960?

A Only on shorts, as I recall.

Hearing Examiner Gross: I can't hear you.

The Witness: Only on shorts.

By Mr. Dickstein:

Q Were you actively trading the shares of Atlantic Research in September of 1960, '61 and thereafter?

A This I will have to check. You may have the records yourself and save me the bother.

Q You mean you don't recall whether you were a trader in those shares?

Mr. Leonard: Objection to the characterization as

Manufacturing Company he said had a wire connector which was unique in design. It was patented, I believe. It was going to be distributed by Westinghouse and General Electric.

Q What else did he say, if you can recall?

A Well, we were going to buy the stock before it went public, and it was expected that we would make a very nice profit from this stock after it went public.

Q Do you recall anything else, sir?

A I recall that there was talk of a split, of the stock splitting before the public offering was to be made.

Q Do you recall anything else?

A No.

Q Well what, if anything, did Mr. Carr tell you about other companies being interested in the Paragon device?

A Well I recall, as I said, General Electric and Westinghouse were going to distribute this by some method, this connector.

Q What, if anything, did Mr. Carr tell you about the purpose or the use of the capital being raised for Paragon?

A By my recollection I don't recall any particular mention being made of the use of the money.

Q What, if anything, did Mr. Carr tell you of the sufficiency of the funds being raised for Paragon?

in Virginia, if not by telephone.

Q But you do not now recall whether they took place at your mother's home or on the street or over the telephone or in the office of Hodgdon and Company, or where they took place; is that correct?

A I don't recall the exact place, no.

Q And you do not recall how many such conversations you had, do you?

A No.

Q You testified in answer to questions by Mr. Webb as to what it was that Mr. Carr said about this company with some precision. How precise is your recollection of your conversation, the actual substance of your conversation with Mr. Carr; that is, what he said to you some five years ago in reference to these shares?

Mr. Leonard: Objection.

Hearing Examiner Gross: Sustained.

By Mr. Dickstein:

Q Do you recall exactly what it was Mr. Carr said to you five years ago?

A Exactly? No. I remember the points of the conversation.

Q Did Mr. Carr say that Paragon had a licensing arrangement or distribution arrangement with General Electric Company, or did he say that they hoped to obtain such an

arrangement?

A My recollection is that the had such an arrangement.

Q That that was what he said?

A (Nodding affirmatively)

Q Did Mr. Carr say that Paragon had a distributing arrangement -- also had a distributing arrangement with the Westinghouse company, or that they were trying to obtain or were seeking such an arrangement?

A To my recollection, yes.

Q The first?

A That they had a licensing arrangement with them.

Q Do you recall being interviewed by telephone by Mr. Webb on April 28th, 1965?

A Yes, I remember being interviewed in '65.

Q Were you interviewed by Mr. Webb or any other representative of the SEC on any other occasion?

A Not that I recall.

Q Well do you definitely recall that this was the only time that you were interviewed?

A The conversation I recollect was in the middle of last year sometime, the first I heard about this.

Q And was that the only conversation?

A Other than today that's all I can recollect.

Q Did you have a conversation with a representative

Q Do you recall if Mr. Kitain discussed the situation with you that you just previously described?

Mr. Shapiro: Again, the same objection.

Hearing Examiner Gross: Overruled.

Read back the question.

(Whereupon, the Reporter read from the record as requested.)

The Witness: Yes.

By Mr. Webb:

Q What did he say to you and what did you say to him?

A He told me that by the end of the year, the interest payment would cover the quarterly payments which I would withdraw. Actually, they did not.

Mr. Shapiro: I'm going to ask to strike the "Actually they did not," as not being responsive.

Hearing Examiner Gross: Strike it.

By Mr. Webb:

Q Did the payments cover the interest?

A No.

Q And you ultimately stopped withdrawal. Is that correct?

A That's right.

Mr. Webb: Would you mark this document, Mr. Reporter as Division Exhibit No. 61 for identification.

stricken and the question is withdrawn.

By Mr. Webb:

Q You indicated he told you it would pay you 9 percent. What else did he tell you? Would you go over it point by point, if you can?

A It was tax-sheltered also. It was a safe investment, paid 9 percent. It was even better than Rock Creek.

Q Did you personally investigate the Rock Creek properties before you made the purchase?

A Yes.

I went down to look at the buildings and came back and told Mr. Kitain that I didn't think they looked too substantial.

Q What did he say to you?

A It didn't matter. They paid well, and I didn't have to live there.

Q Do you recall making a purchase of 25 shares of Wise Homes, Incorporated?

A Yes.

Q Upon whose recommendation did you make that purchase?

A Mr. Kitain recommended it.

Q What did Mr. Kitain tell you about Wise Homes?

A Wise Homes was a better investment than Jim Walters.

Q If you know, what happened to the price of Wise

Homes, Inc. soon after you purchased it?

Mr. Shapiro: Objection.

Hearing Examiner Gross: The grounds?

Mr. Shapiro: We're asking now for a result.

Mr. Webb: I'm not asking for a result.

Hearing Examiner Gross: I'll take it.

The Witness: Wise Homes continued going down, and I talked with Mr. Kitain and asked him what was wrong, and he said they wanted the stock to go down because they wanted to put all their people into this stock.

Hearing Examiner Gross: They wanted to do what?

The Witness: They wanted the stock to go down because they wanted to put all their people into this stock.

By Mr. Webb:

Q When you say "they," whom do you mean by that,
Mrs. Avin?

A Hodgdon and Company.

Q Did Mr. Kitain ever discuss with you your 70,000
trust which you described earlier?

A Yes.

Mr. Kitain thought I could have a better income
if I would also put part of my trust into these realty holdings.

Q Well, when did he discuss with you the trust fund
that you had, approximately?

A Some time in '60.

It was to be used for that purpose; also for detecting railroad hot boxes and -- well, I don't remember the full details of that. But certainly it was for a venture that was speculative, and to make money.

Q You indicated, sir, that he sent you a document, a nine-page document. What did he tell you in an oral conversation, if he did speak to you about this?

A Well he told me about this new venture, that it would be profitable for me even though it would be speculative; that at this particular point this was the initial opportunity; that there would be another -- or that the firm would go public at a higher price later on, and that here we were coming in at the initial -- on the ground floor.

Q What else do you recall, sir, in this conversation?

A Well I do recall that it was a speculative venture. It was speculation that I would be going into. However I certainly expected to make a profit.

I do remember in this particular document there was a reference to the fact that the Hodgdon firm did not -- it was not with their approval. However in my mind I certainly knew that the Hodgdon firm must be aware of the fact that their salesmen are involved in it.

Mr. Shapiro: I'm going to have to move to strike the last portion of the answer.

household goods

Q Do you have any conversation?

A On the later appointments

Q Now, this discussion

A Well, he went down and at that time he went to the phone only in

Q Was this meeting?

A In this information about shipping, et cetera

He asked him if they had developed a new material with which to ship or which to use in this container and he said No, it was just a new way that had been developed that they could reuse the same container.

So after that little discussion he went on and then told me about the growth possibilities of Van-Pak, that it had not done very well in the previous year, and that they had made some money which had been reinvested in the company. And then he told me that they had talked to the

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household goods or items in.

Q Do you recall anything else he said during that conversation?

A On the phone? No, except that I was to make a later appointment to see Mr. Kibler.

Q Now, during this discussion, what transpired after this discussion?

A Well, after I made an appointment to see him I went down and talked to Mr. Kibler about Van-Pak, at which time he went into approximately the same conversation on the phone only in more details.

Q Will you tell us the details of this second meeting?

A In this conversation, he gave me a little more information about Van-Pak. He went through the same information about the containerized method as a new means of shipping, et cetera, and I asked him if they had developed a new material with which to ship or which to use in this container and he said No, it was just a new way that had been developed that they could reuse the same container.

So after that little discussion he went on and then told me about the growth possibilities of Van-Pak, that it had not done very well in the previous year, and that they had made some money which had been reinvested in the company. And then he told me that they had talked to the

State Department and it had been cleared with the State Department, their means of shipping, and that the State Department had informed them that they would okay their type or means of shipping household goods or other items overseas for their civilian personnel, and at which time Mr. Kibler mentioned that of course AID and a few other agencies fell under State Department which would be included in this agreement with the State Department.

They did have some contracts with the Defense Department and they expected to get a large number of contracts through AID and the State Department and other agencies which fell under the State Department.

And then he gave me the possibilities of the growth of the stock. He expected by late fall that in all probability that it would increase a point or two or a couple of points, and then he gave me a little more information about over the period of time they expected the stock to do very good, within a year or two, that it would increase rather rapidly in his opinion.

Q Did he tell you any reason why he expected this stock to increase rapidly?

A Well, mainly for one reason, that the State Department had cleared that and they expected to get a great deal or a great number of orders or whatever you refer to through the State Department for moving their personnel.

Q Were all these purchases made at Mr. Hodgdon's recommendation?

A Yes.

Q Do you recall any instance in which you did not follow the advice of Mr. Hodgdon?

A No.

Q Do you recall any purchase that was made at your suggestion?

A No.

Q Do you recall purchasing Van-Pak securities?

A Yes, sir.

Q Approximately when did this purchase take place?

A Around April of 1962.

Q Would you describe the circumstances surrounding the purchase?

A Mr. Hodgdon called me on the telephone and explained what this security was.

Q Just what did he say Van-Pak was? Rather than summarizing, what did he say that Van-Pak was? Tell us in detail.

A Well, he said Van-Pak was a new type of moving company, that they had developed a new type of container in which they were going to ship goods, household goods, especially service men, and that they were supposed to have or be obtaining Government contracts whereby they would move

these servicemen, especially overseas.

Q What else did he say about Van-Pak?

A Well, that was the essence of it. He felt that it was a good investment, that it should grow rapidly because of these Government contracts.

Q What, if anything, was said with regard to dividends?

A I believe he said they were not at the time paying dividends but they expected to start paying dividends.

Q What, if anything, was said about Government contracts?

Mr. Shapiro: The witness has already testified to that. If you wish to refresh her recollection, do so.

Hearing Examiner Gross: Overruled.

Mr. Timmeny: Read the question back, please.

(Whereupon, the Reporter read from the record as requested.)

The Witness: He said that Van-Pak was expecting to get Government contracts.

By Mr. Timmeny:

Q What, if anything, was said about the company's forecasts, its future?

A They expected it to be very good.

Q Did Mr. Hodgdon attempt to characterize the general nature of the investment?

A Not other than that it was a good investment.

he felt, for me.

Q What, if anything, was said about profits in Van-Pak, realizing a profit?

A He felt like I would realize a good profit from it.

Q Did he mention a period of time?

Mr. Shapiro: I'm going to have to object to the last question about what he felt.

Hearing Examiner Gross: I think it is pretty evident the witness has exhausted her recollection of the previous conversation and I think in that light the question is proper.

Go ahead.

Mr. Timmeny: Would you read back the question, please?

(Whereupon, the Reporter read from the record as requested.)

The Witness: Not specifically. I would say short-time would cover it.

Hearing Examiner Gross: Is that what he said?

The Witness: I recall he said a short time. I don't remember anything specific.

By Mr. Timmeny:

Q Now you testified that this all took place during the phone conversation.

A I don't recall that he did say anything. If he did, I don't recall it.

Q Did he discuss the services that the firm would offer?

A I don't recall that he did, no.

Q Have you ever purchased Van-Pak, Inc. securities?

A Yes.

Q Would you tell us the circumstances surrounding your purchase of Van-Pak, Inc.?

A Well, I called Mr. Haight one day and told him that I had about \$500 to invest and I was wondering what stock I could invest in. After talking for a few minutes, he mentioned the Van-Pak to me, and he said -- I believe he said that it was a speculative stock but similar stocks he had recommended to other customers had turned out very well.

Q I'm sorry, I didn't hear that last.

A That similar stocks he had recommended to other customers had turned out well.

Q What else was said about Van-Pak?

A When the price doubled, I could sell half and regain my original investment.

Q Did you purchase Van-Pak during this phone conversation?

A Yes, I did.

Q About how long had the --

A I couldn't tell you. It was on Dinwiddie Street in Arlington, but I couldn't tell you the exact address.

The individual was Francis X. Gilhool.

Q Was this near your home or some distance away?

A It's about a mile away.

Q What happened?

A I received a call at Mr. Gilhool's home from Mr. Carr. He said that he had a situation that he thought I might be interested in, pointing out that it was Van-Pak, and that they were developing or had developed a new type shipping container that was something very much in demand by the shipping industry, and that he felt certain that the stock would appreciate considerably because of the great demand for this product.

Q At this time, did you answer the telephone?

A No, I did not.

Q Who did answer the telephone?

A As I recall, it was Mr. Gilhool.

Q And what did he say to you?

A He told me I was wanted on the phone, that it was Mr. Carr, and he introduced himself and said he had this situation and thought I should be aware of it right away, and then went into what the security was.

Q Did Mr. Carr indicate to you whether he had tried to reach you at home?

Mr. Shapiro: Objection.

Hearing Examiner Gross: Sustained.

By Mr. Timmeny:

Q What other aspects of this situation do you recall?

A Well, I assume --

Mr. Shapiro: Objection to anything assumed.

Hearing Examiner Gross: Tell us anything that was said in the course of the conversation with Mr. Carr, what he said to you and what you said to him, the substance, if you can recall.

The Witness: Well, I do recall asking Mr. Carr if he had a prospectus. He said that he had, and he would send it to me. And I asked him if I could wait until then. He indicated that it was fairly urgent that I make up my mind now, that he only had a very limited number of shares left, and by the time I got the prospectus perhaps he wouldn't have the securities to sell me.

By Mr. Timmeny:

Q During this conversation, did you authorize Mr. Carr to order Van-Pak for you?

A Yes, I did, 100 shares.

Q One hundred shares?

A Yes.

Q At what price?

A \$5 per share.

per share, and I asked him what was available and he suggested I take a hundred shares.

Q What, if anything, was said about future prospects of the stock?

A Well, he stated that he was certain that the stock would appreciate and that I would make money on it by virtue of the demands that were going to be made on the company for the manufacture of this product.

Q Did he estimate how high the price would go?

A To the best of my recollection, he indicated it would double or better over a period of time.

Q How long a period?

A Over six months, as I recall.

Q During this conversation, did Mr. Carr say whether or not these securities were registered for sale in the State of Virginia?

A No, sir.

Q Prior to this conversation, what had been your last contact with Mr. Carr?

A Well, I had seen him occasionally at different places about town but hadn't had any business transactions.

Q How long a period since your last business transaction?

A Probably five or six years.

However, I had been contacted by other

representatives of the company during that period.

Q Had you had any other purchases through Hodgdon and Company during that period?

A No, sir.

Q Had you made efforts to reach Mr. Carr during that period?

A I had on occasion and he was always tied up, and I always-- It was my opinion that he was not particularly in the field of selling but he was more in the management field.

Mr. Shapiro: I am going to object.

Hearing Examiner Gross: Sustained.

Everything after "it was my opinion", strike.

By Mr. Timmeny:

Q During this conversation with Mr. Carr in regard to Van-Pak, what, if anything was said about Van-Pak's financial condition?

A Nothing that I-- Nothing.

Q And you have indicated that you directed Mr. Carr to order Van-Pak for you during this conversation?

A That is correct.

Q Did you receive a prospectus?

A Yes, I did, at my request.

Q Did you read the prospectus?

A Yes, I did.

Q Then what happened after that?

A Well, as I said, we talked subsequent to the first visit.

Q About how long after?

A I think the visits were rather of short interval. They were within a relatively short period of time.

On these visits, Mr. Davis told me that this stock -- that this company was going to be a terrific investment, that it was a real hot issue, that he didn't think I could afford to pass this up, that the company had some type of a new process of storage or moving, and that they expected to get substantial Government contracts that would materially increase the value of the stock in a very short time.

As I said before, I told him that I didn't have any money at the time to invest, but I did have ten shares of General Motors stock that I had purchased and held for some time. Mr. Davis said that the General Motors stock had not moved, which at that time was true. It had not. It was at about the same price I bought it.

And he suggested that I sell the ten shares of General Motors stock and buy 100 shares of Van-Pak, which was then \$5 a share. As I say, he represented to me that this stock was going to be a good, sound investment and, more than that, that it was likely to appreciate two or

three or four times in a very quick period of time.

Q Did you order Van-Pak during one of these conversations with Mr. Davis?

A Yes.

Q Did you purchase Van-Pak?

A Yes.

Q How did you pay for your purchase?

A My recollection is that I paid for it on an exchange of selling the ten shares of General Motors stock through Hodgdon and Company. The money from the sale of the General Motors stock was applied to the purchase of the Van-Pak, and I think I got back a credit of \$45 or \$46.

Mr. Timmeny: Mr. Reporter, I ask that you mark these two documents for identification as Division Exhibits No. 106(a) and (b).

(The documents were marked
Division Exhibit 106(a) and
(b) for identification.)

(Documents handed to Counsel for the Respondents.)

Mr. Shapiro: No objection.

Mr. Timmeny: I offer in evidence Division Exhibit 106(a), which is a confirmation for the sale of ten shares of General Motors stock at 55-3/4 with a trade date of February 23, 1962, addressed to Mr. Donald R. Brenner, and Mrs. Sandra F. Brenner, 3700 Mass. Avenue, N. W., Washington,

but also what our eventual reason for investing, whether we needed income now or income later or growth or what.

Q What did you tell him as to your objectives at that time?

A We wanted financial independence in the future. We didn't need money at the present time.

Q What did Mr. Davis tell you?

A He drew out a schedule there for us where we should have a certain amount of money in conservative -- My husband was more interested in conservative type stocks and some speculative, and that we should have it divided in certain percentages as far as the investment picture was concerned.

He also called in at that time Mr. Kelly who was their insurance counsellor at that point to go over our insurance picture so that they could show us what they wanted to do, show us how we would be self-insured through proper investments. They drew a little diagram showing how insurance costs go up this way but proper investments come across and at the point they meet, you are self-insured.

So he recommended that we sell our insurance, turn it in for cash value and then just buy term insurance.

Q Who recommended that?

Mr. Shapiro: Just a moment. May I hear the witness finish her answer?

Hearing Examiner Gross: Do you want it read back?

Mr. Shapiro: No, I would like to have the witness finish her answer.

Were you still talking?

The Witness: Yes.

Hearing Examiner Gross: All right, finish your answer.

The Witness: Mr. Davis and Mr. Kelly said for us to sell what we had and to purchase \$10,000 in term insurance and Mr. Kelly would be able to select a company which would give us a straight-cost term insurance, and at the point we would be self-insured they would let us know so we would just cancel that and then from then on, we would be self-insured at that point.

By Mr. Webb:

Q Did you take that recommendation?

A Yes, we did.

We got our cash savings which we invested in stocks which Mr. Davis recommended to us.

Q Did you purchase insurance through the Hodgdon firm?

A Through Mr. Kelly of the Hodgdon firm, and we still carry that insurance.

Q Do you recall anything else about that conversation which you have just described?

A Yes.

Mr. Davis explained to us that the Hodgdon way of investing was an overall type thing and that it had-- They had to have the complete picture in order to help us. It couldn't be an isolated thing of just buying something or selling something, that it was the idea of building a cushion or building a reserve to call upon it at future times when we would need it, and that they needed the overall picture of our resources and investments in order to be fully helpful to us.

Q Do you recall anything else?

A Well, the fact that anything that he would suggest that we buy would be something that the company would certainly be behind it and have good knowledge of, that Mr. Hodgdon in most cases would be a director on the board of these things and know well what was going on in the company and that he himself would not tell us anything to invest that he himself did not have some of, too.

Q Do you recall anything else, Mrs. McMullen?

A Well, the fact that we would have to have complete confidence in him and confide in him totally and have faith in his judgment as to the various things, you know, that we would be going into or that he would be suggesting to us.

Q What, if anything, was mentioned about the Hodgdon services?

A Well, that we as clients, as every client or every account that Hodgdon would have, would have the availability of any services that they provided. They had experts in the various fields there, and that even as a small investor, which we would be, we would have the benefit of all of these -- of the knowledge that these experts had.

Q Do you recall what type of experts were there?

A Well, the insurance, for one, the man that we met, but it was an overall thing that they had. I don't know specific gentlemen for specific areas.

Q What was your experience and your husband's experience in securities at the time when you spoke to Mr. Davis in 1960?

A My husband at that time had had no prior experience. My prior experience was what I explained to you in the fall of '58 where I met Mr. Davis.

Q When you purchased one security?

A And purchased the one, the Putnam.

Q The Putnam Growth. That was the only transaction prior to the-- I believe there was also Mid-America Life, a purchase in '59?

A Yes.

That followed the Putnam.

Q But there were no other transactions with other brokerage firms prior to --

A Yes.

All of these real estate funds he felt would be in the vicinity, as he said, of 9 to 13, probably 9 percent, or 9-1/2 would be the most likely level at which it would sell.

Q What if anything was mentioned about the relative safety of this particular investment, Metropolitan?

Hearing Examiner Gross: Relative what?

Mr. Webb: Safety.

The Witness: Well, this was a new offering in the real estate field. It was a special type thing, though. That's what he said.

By Mr. Webb:

Q What did he say about a special type thing?

A Well, certain things that Mr. Davis told us about he said would be speculative; in that our aim was long-term growth, he said his advice to us was that he didn't know of anybody who ever got rich on blue chips because they just varied a few points, and anybody who was going to make money on it made it many, many years ago, and that these would be the blue chips of tomorrow, this sort of thing, and that we should-- Being in the position that we were, that we were looking for long-term growth, that you do have a certain degree of risk in a speculation but that we were in a position by the fact that our responsibilities were few, would be

able to have an occasional loss in these that would be more than offset by the great growth in those that were successful.

He explained this to us but he also said that all of these things that he was offering to us were things that he had faith in, too, that he owned himself and that the company had-- Generally Mr. Hodgdon would be on the board of directors or in some way very knowledgeable.

Mr. Shapiro: Just a moment.

Am I correct, is that in response to the specific question, or the specific security we are talking about now?

Mr. Webb: My understanding of the testimony is that Mrs. McMullan is testifying as to this security and other similar securities.

Hearing Examiner Gross: It is my understanding.

Is that correct?

The Witness: That's correct.

Hearing Examiner Gross: All right.

By Mr. Webb:

Q Well, Mrs. McMullan, do you recall a purchase of 40 shares of Salada Foods in August of 1961?

A Yes, I do.

Q Upon whose recommendation was that?

A Mr. Davis.

Q Do you recall what Mr. Davis told you about

5 The Witness: And it also states in here in
about two years we would double our investment. This is
something that he stated about all of the things, that
we would make great profits. And he generally told us
about how much we could expect and in what length of
time we could expect it.

By Mr. Webb:

Q What about the yield?

A There has been no yield.

Q I realize that. But what did he say in that
conversation, looking at those notes?

A I would have to look at them again.

(Document handed to the witness.)

Well it was being offered at five dollars a
share and he would say it would be worth about ten dollars
a share in two years.

Mr. Shapiro: Let the record reflect that the
witness is reading from the document she is holding, rather
than testifying.

The Witness: This is Metropolitan Securities
in which it is stated 10 percent.

Mr. Shapiro: I'm sorry, I can't hear the witness.

By Mr. Webb:

Q Will you tell us the conversation regarding the
10 percent?

and I ask you whether you can identify that sheet of paper?

(Handing document to the witness.)

A Yes. This is a transcription of my notes about Orbit as described to me by Mr. Davis.

Q As I understand your testimony you are sketchy on this conversation. Does that refresh your recollection?

Mr. Dickstein: Objection. No foundation.

Hearing Examiner Gross: Have you told us everything that you remember about the conversation with Mr. Davis regarding Orbit?

The Witness: Other than the fact that we could expect a great profit from it.

Hearing Examiner Gross: Do you recall that he said that?

The Witness: Yes.

Hearing Examiner Gross: All right.

Go ahead.

By Mr. Wobb:

Q Would you please look at that sheet of paper and see whether that can refresh your recollection as to what amount of profit was mentioned?

A Yes. He said 1 to 3 points profit, 25 to 75 percent.

Q And what was the original purchase price?

A Four dollars.

Mr. Webb: I will offer Division Exhibit No. 117 into evidence.

Mr. Dickstein: Same objection.

Hearing Examiner Gross: Same ruling.

The Witness: May I say something further?
I seem to be coming back with thoughts about Scope. But I think this is most important, if I may say something about it.

Hearing Examiner Gross: Say it.

The Witness: At the time Mr. Davis offered us Scope he said that the only way he was allowed to offer it to us was in blocks of 100 shares only, that you could not purchase any less than that. And it had to be multiples of that if you wanted more than that.

So we did tell him to buy us 100 shares. At the time that it was given to us he called to say he could only get us 50 shares, we couldn't have 100.

By Mr. Webb:

Q Mrs. McMullan, do you recall purchasing in February of 1962 50 shares of VanPak, Inc. common stock?

A Yes, I do.

Q Upon whose recommendation was that purchase?

A Mr. Davis'.

Q Do you recall what Mr. Davis told you in connection

with this purchase?

A Yes, I do. He said that for two or three years there had been an attempt -- they had attempted to be able to be exempt from a certain ICC ruling which would allow them to expand from a very few locations to many, many locations throughout the world. And that it was a revolutionary new process of containerized moving of household goods, and they expected a great amount of business from the government with moving household goods of servicemen that are stationed around the world. And that it was only good for long term, not for short haul or anything like that; that it was only competitive for long distances. And that by being able to avoid this ruling, or having received this ruling of the ICC, that they could be most competitive and be a good percentage below their competitors like Mayflower or the other large carriers of household goods.

Q Do you recall anything else, Mrs. McMullan?

A Well, that they expected this whole thing to be culminated within a short time, and that it was ready to really move. And all of the slack time of it had already passed, that things were ready for culmination at this point. And they really, you know, start with, oh, I think something like 550 bases of operation throughout the world. And it would be very fast from now on to expand.

Q And did you have any conversation with Mr. Davis after you received that prospectus in relation to those markings?

A Yes, we did.

Q Will you tell us about that conversation as to what he told you and what you told him?

A My husband had great reservation about this offering. And he said to Mr. Davis, you know, it just looked dreadful. And he at that time said just to ignore the prospectus, any prospectus just looks terrible. And that you have to move on the basis of their knowledge of what is going to happen. That certain regulations are required as to what you can put in a prospectus, and it always paints a very black picture.

Q Whose knowledge? You mentioned somebody's knowledge.

A The knowledge of Hodgdon and Company and their experts.

Q On the first page it says "Charley, see pages 6 and 9." Do you recall any conversation with respect to pages 6 and 9?

A Yes. Mr. Davis marked where it showed income and loss. And this was where my husband had made the pertinent question.

Mr. Dickstein: I'm sorry, Mrs. McMillan. I

purchases of Apache Realty Corporation.

A I am sure I made notes at the time, because I would have had to describe this to my husband.

Q But did you-- I withdraw that.

And that would have been the purpose of your taking such notes?

A Yes.

Q Did you make any notes, either in shorthand or in transcribed form from shorthand, regarding any conversations with Mr. Davis pertaining to your purchase of Dart Drug?

A I don't recall offhand if I have that or not.

Q You don't recall whether you made notes or not?

A In every case I made notes at the time of the conversation with him, with the exception of those few times that we did not purchase during 1960 because our funds were limited.

Q You mean you made notes whether you purchased or not?

A I made notes whether I purchased or not in every instance where I thought there was a possibility that we might invest.

During the course of conversations with Mr. Davis where he offered things to us during 1960 when I was not working, and I know we did not have the funds--

A Yes. And it was as a direct result of speaking with Mr. Davis about Van-Pak.

Q But did you not already have a prospectus in your possession at the time you transcribed these notes?

A No. Because it was not the general manner of procedure for Mr. Davis to give us a prospectus at first.

Our reliance was completely upon him, and it was only because my husband had reservations about this offering that he insisted upon seeing a prospectus before he made his decision.

Q Can you tell us the context or circumstances of Mr. Davis' comment to you that what is shown in the prospectus shows experiment costs for three or four years, shows expenses rather than capital outlays?

A This I feel was because my husband had the reservations about this and wanted the prospectus, and I feel that this was said to me by Mr. Davis between the time he mailed the prospectus to us and the time we received it. And this was an explanation of his comment and marks in the prospectus.

Q And this, then, would have been transcribed at least after your second conversation with Mr. Davis, would it not?

A As far as pinpointing the exact time that this was written, I would have to say that I am not certain

you about the ICC status of Van-Pak?

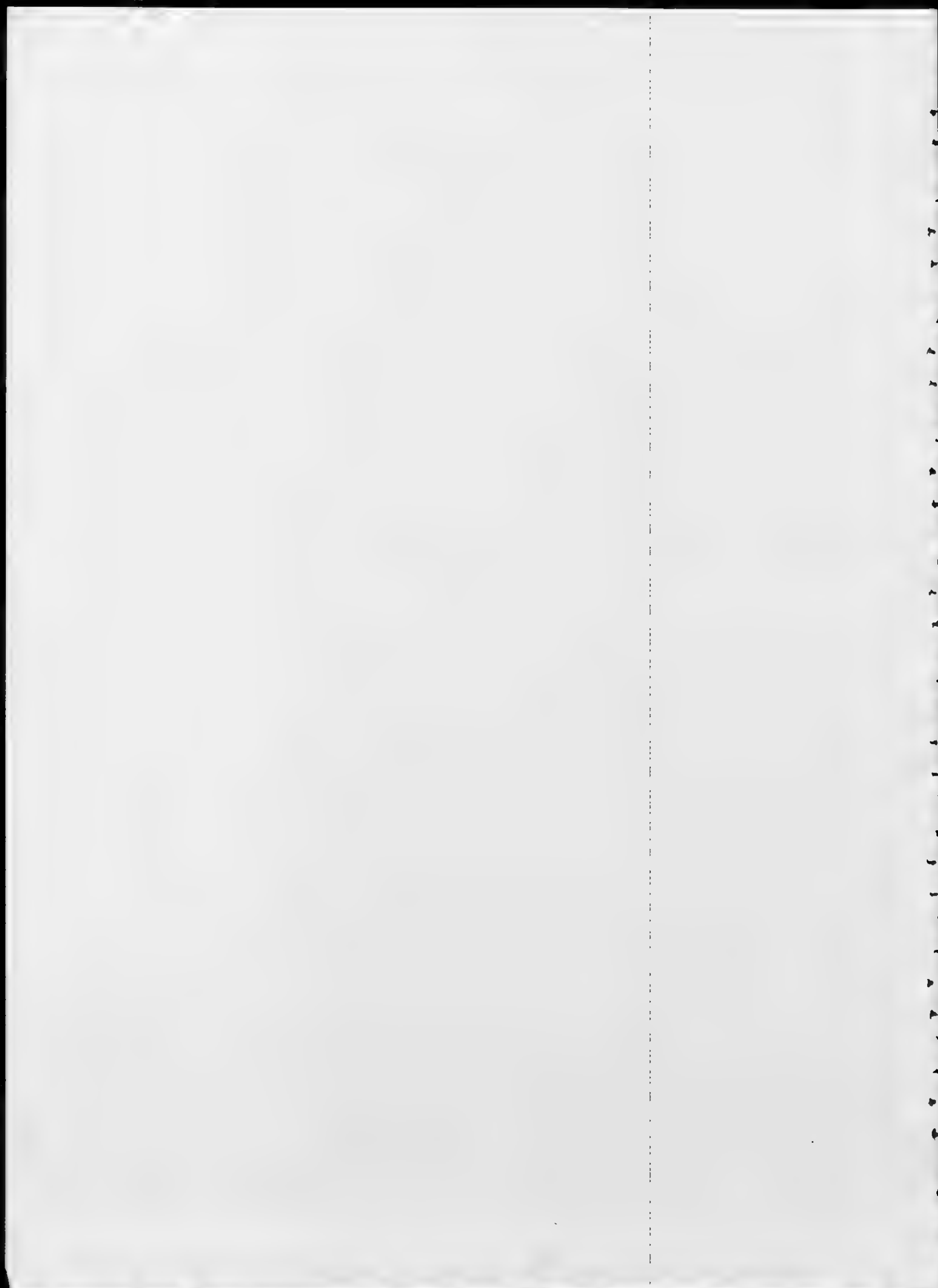
A I recall that he said they had been working for two or three years to -- I don't know whether it was to reverse a ruling or to make them exempt from a ruling, or just what it was; but whatever it was, it had been culminated and now they were able to expand their base of operations from a few locations to about five hundred and fifty locations around the world, and that they would have contracts with the government for the transportation of household goods of veterans, military personnel and civilian personnel for the government around the world, and that it would enjoy very good sales, and it was at the point now where this would start.

Q Isn't it a fact that Mr. Davis told you that Van-Pak had formerly been in business as an ICC certificated carrier?

A I don't understand that. Would you repeat it?

Q Isn't it a fact that Mr. Davis told you that Van-Pak had formerly engaged in business as an ICC certificated carrier?

A I don't understand that question. My understanding was that there was something about other companies being regulated by the ICC, such as Mayflower and all of these others. There was something about a ruling that carriers had to follow or abide by, that they, as a result



cross-examination the way the question is framed. I think the usual procedure -- and if I am wrong, you correct me now -- I think is to ask her, does she recall what she testified? If she recalls, then other than that he assumes certain parts of it in the question.

The witness doesn't have a chance to say whether she does or does not --

Hearing Examiner Gross: This is a question on cross-examination, Mr. Leonard. The witness can either say Yes or No.

Mr. Leonard: My objection is that it isn't susceptible to that.

Mr. Dickstein: It assumes merely a fact in evidence to which she testified.

Hearing Examiner Gross: Proceed. There is a ruling.

Answer the question, please.

The Witness: Van-Pak is the one that my husband insisted that we see beforehand. Other prospectuses were sent to us with the confirmation.

By Mr. Dickstein:

Q And when you received them, did you look at them?

A No.

I wouldn't know what they truly meant. I might glance at them, but not really read to understand.

Our whole decision to purchase would be based on what Mr. Davis told us.

Q I understand that, Mrs. McMullan.

You say you might have glanced at them?

A "Here it is," that would be the thing. We certainly did not read them.

Q When you say "we did not read them," -- I'm not asking whether you read them from cover to cover, or whether you read them with understanding. I am asking you whether you -- let's talk about you as distinguished from your husband -- looked at them?

A The cover, to file, but not to read.

Q You never turned beyond the cover page?

A Oh, possibly flipped through but never to read.

As I say, the decision was made when we received the prospectus.

Q Which ones did you flip through?

A I could never say that.

Q Are you saying that some you flipped through and some you did not?

A I am saying that the matter was a closed matter in our minds by the time we received the prospectus. Our reliance was totally on Mr. Davis. I would not understand what the prospectus would say. I did understand what Mr. Davis said, for the most part.

Q But whether you understood it or not, on some occasions you flipped through the prospectus?

A The same as you would flip through any magazine or anything else.

Q On all occasions, would you at least look at the first page, the cover of the prospectus?

A It would depend entirely upon my personal schedule, how rushed I was at the time.

Q What about your husband? Did he ever flip through the prospectuses?

A My husband and I did not arrive home at the same time and I do not know what my husband did.

Q Aside from the Van-Pak prospectus, did you ever have any occasion to discuss a prospectus with your husband?

Hearing Examiner Gross: With whom?

By Mr. Dickstein:

Q With your husband?

A We discussed that prospectus (indicating) because --

Q Excuse me.

When you say "that prospectus" you are referring to --

A Van-Pak.

Q I asked, aside from Van-Pak?

A I don't believe that we did discuss it. We had been advised by Mr. Davis that the way the prospectus was

written was always very bleak, a very sad picture and that if people based their decision to purchase on the basis of the prospectus, nobody would ever put a cent into anything.

Q I believe you testified you were told that in connection with the Van-Pak prospectus?

A He told us this about, if I remember correctly, about every -- about anything, whenever the question came up. I don't recall immediately when our question came up.

Q Well, would that question have come up before the Van-Pak?

A As I say, I do not remember when.

Q Well, did you ever see a prospectus, other than Van-Pak, prior to what you refer to as your decision to purchase?

A Each time, as I said, the prospectus came with the confirmation in the mail.

Q Except in the case of Van-Pak?

A And that was upon our insistence. We would have followed the normal routine if my husband had not insisted that we see it, and when Mr. Davis agreed to send it, he said, "I will send it, but don't pay any attention to it. It will not reflect what the situation truly is."

Q Do you recall Mr. Davis ever saying that with regard to any prospectus other than the Van-Pak prospectus?

A When he said this, my recollection is that this

was in reference to all such offerings because of the way the regulations stated a prospectus must be written.

Q Do you recall him saying that on any occasion other than your discussion of Van-Pak?

A As I say, I don't know when the discussion came up. I could not testify to when the discussion came up. When it came up, Mr. Davis explained to us that the prospectus never reflected what was going to happen. The regulations precluded that being in the prospectus itself.

Q And your best recollection is that that statement was made in connection with your consideration of the purchase of Van-Pak?

A I do not know when that came up, as I have stated several times to you.

Q You did look at the Van-Pak prospectus, did you not?

A Yes.

Q Did you look at that portion of the prospectus right on the cover sheet which describes the amount of underwriting discount and commissions payable to the underwriter in connection with the sale of these securities?

(Handing document to the witness.)

A This in red?

Q No, Ma'am. I refer to the numbers at the top in black.

A Washington, D. C.

Q And who was present at this meeting besides you and Mr. Harper?

A As far as I remember, only he and I were there.

Q How long did the conference last, as best you can recall?

A At least an hour.

Q And during this conference, Mrs. Metger, what did Mr. Harper say to you, and what did you tell him?

A Mr. Harper said, when I told him I had no experience with investment matters, that I had never worked through a broker other than for that Philadelphia Fund, that they were counsellors and that their specialty was financial planning for people who wanted to increase their returns, and that I should consider him like my doctor, that he would then be able to kind of diagnose my financial potentials and possibilities.

I reacted to this with confidence. They, after all, are a big company and set up for the purpose of financial counselling.

Q Do you recall anything else, Mrs. Metger, about this face-to-face conference?

A I was told by Mrs. Harper that they had a formula of investment policy for people like me with this particular purpose in mind, increasing retirement income, and he spoke

do not remember. I just am not sure. He may have. I don't remember.

Q Do you recall purchasing one unit of West Falls Shopping Center in July of '62 for \$1,000?

A Yes.

Q Upon whose recommendation?

A Mr. Harper's.

Q What if anything did Mr. Harper tell you about West Falls?

A That they were operating the shopping center in the shopping center and that --

Q Who is "they"?

A Well, the company that owned the shopping center. I don't remember whether he told me that they were the owners of the shopping center or partners in it. I know that it was in a shopping center and that it was at that time supposed to be a good location and had good tenants, and so I invested. I thought one could not lose in a shopping center.

Q Do you recall what he told you, if anything, about the yield?

A Good yield; I don't recall the percentage.

Q All right.

Do you recall purchasing one unit of Lord of the Flies in August of '62 for \$525?

A Yes, I remember that. I do, yes.

Q Upon whose recommendation was that purchase?

A Mr. Harper's.

Q And what did Mr. Harper tell you about Lord of the Flies?

A He told me that this was a movie made from a book that was very widely read in colleges; that it would probably be very popular with young people and that I could probably double my money on it within two or three years, as far as I remember.

Q Do you recall how many times Mr. Harper called you about Lord of the Flies?

A Well, several times, because I had never invested in a movie and I felt very insecure about that, and my husband did not like the idea at all.

Q Do you recall purchasing one unit of Richmond Motor Lodge for a thousand dollars in October of '62?

A Yes.

Q Upon whose recommendation?

A Mr. Harper's.

Q Do you recall what Mr. Harper said about Richmond Motor Lodge?

A That this was part of the Holiday Inn chain-- Is it a chain? -- and that they were located at a very favorable point, a business route through that area and that it had a very good chance of more or less full occupancy

The Witness: On the 27th of August.

Hearing Examiner Gross: All right.

Let the record indicate that I will take the question now and the answer, and if it develops that Mr. Hirsch feels that there will be problems with respect to it, we will resolve it at a later time and, if necessary, have the witness back.

Go ahead, ask your question, Mr. Webb.

By Mr. Webb:

Q What did Mr. Harper tell you about Roseville, if you can recall?

A I don't think I can recall.

You will notice in the later investments I become more and more hesitant about answering details of conversations because I got into a kind of relationship, like a patient and a doctor, really, like a doctor prescribes something and you don't question what is in it. So I relied upon Mr. Harper telling me about things that were proper.

Hearing Examiner Gross: Do you recall anything Mr. Harper said about Roseville?

The Witness: I don't really. I don't recall.

Hearing Examiner Gross: All right.

Go ahead.

By Mr. Webb:

Q Do you recall any instances where Mr. Harper would

bring to your attention or recommend a security in which you did not follow his recommendation?

A Occasionally I did not follow his recommendation.

Q What were those circumstances?

A Oh, it would be that I just did not like what I read in the prospectuses, or my husband had some hesitation about it. Very infrequently though. We read the prospectus and we didn't really understand it too well, it is so involved.

Q Well, at what point in time did you possibly not go along with some of these recommendations?

A Well, it might also be that I didn't have the funds or I had other plans, like travelling or so, that I could not take another thousand dollars from my dwindling account. It was usually that, I think.

Q Where did you get the funds -- just so we're clear on this point -- to purchase the various securities that were recommended?

A Where did I get the funds?

Q Yes.

A They were my savings, my life's savings.

Q Out of where?

A Out of my work.

Q I know, but what particular funds did you take out?

A Well, I had it all in savings and loan.

[1956]

the latter part of 1961 I bought some Watson Electronics stock there. This was about the time of the U-2 incident in which they were interested in sharpening up aerial photography devices and this particular firm had a means of doing this, and I became interested in the stock, and did buy some from Mr. Kitain.

Q Well, have you ever had any dealings in a stock called Van-Pak?

A Yes, sir.

Q Who brought Van-Pak to your attention?

A Mr. Kitain did, in 1962. I purchased the stock from him in March; on March 28th, 1962.

Q How did he contact you with regard to that?

A He called me at work and indicated that he had a stock that had very fine prospects of doubling itself in approximately six to nine months due to the fact that they were going to be doing war work with the Government industries for the transportation of the household effects of service people, and that they had a container that was substantially better than most in this business, and they thought that they would be able to greatly increase their business.

He did further state that he thought it was a good investment, that he was investing in this particular thing himself.

Q Would you speak up, sir?

A Yes.

They told me they were looking for men of intelligence and of selling ability,

Those are the main things that I recall about those interviews.

Q Well, did they tell you how the Hodgdon firm was unique in the brokerage business?

A As I recall, I was told they were unique in that they offered a wider variety of services to the public and to their clients.

Q What were these services?

A They came under the heading of financial planning.

I don't recall specifically going into any detail at that particular time about these services.

Q What, if anything, did they tell you about the type of securities that were being sold by that firm?

A I don't recall any discussion on that point, either, at that time.

Q After you were hired by the Hodgdon firm, did you attend its training program?

A Yes, sir.

Q And when did you attend the course?

A As I recall, the course was commenced some time in October, possibly early November of 1960, and was finished

A Well, the book itself was not used a great deal, as I recall, during the sessions. We were assigned readings in the book, and the subject matter was discussed, as I recall, briefly.

As the course progressed, the emphasis was more on sales training, becoming acquainted with mutual fund shares and questions on the book under discussion became less frequent, as I recall.

Q Well, were you given any exams on the book you mentioned?

A Were we given exams on the book?

Q Yes, sir, to test your ability to absorb the readings?

A I don't recall.

Q Well, during the training course, what, if anything, were you taught about finding and selling new customers?

A We were advised to begin thinking about acquiring a list of names to be used when the training program was over. We could find such lists, it was pointed out, in Government directories. I personally used the Yellow Pages.

Q What other areas were explained to you as possibly where you could get customers besides the Yellow Pages and the Government directories?

A I don't recall any other sources mentioned.

Q Who told you how to get these sources?

A I don't recall anybody telling me how to get them. I recall Mr. Haight saying we should prepare our thinking, you know, along those lines because when we began working for the firm after the training program was over, we would have to be able to call on someone, and it was suggested to look about for likely lists of names.

Q Well, were any lists mentioned, and if they were mentioned, who mentioned them?

Did Mr. Haight explain to you what directories he used, if any?

Mr. Hirsch: It seems there is already a question pending. I didn't hear the answer.

Hearing Examiner Gross: Yes, answer the first question.

The Witness: Would you repeat the first question, please?

Mr. Webb: Mr. Reporter, would you repeat the first question, please?

(Whereupon, the Reporter read from the record as requested.)

The Witness: As I recall, it was suggested by Mr. Haight that Government agencies publish telephone directories; the Yellow Pages; the telephone directory, such lists as these.

By Mr. Webb:

Q What if anything was told to you about how to approach new customers during this training course?

A We were told that in order to be successful in the securities business and to be successful according to proven techniques, that if we were to make 40 phone calls a day and to see two people a day, that this would be successful.

Now regarding those calls, we were taught how to make the initial call and as I recall, we were given a sales presentation which was typewritten -- not a sales presentation but a prospecting call, how we would --

Hearing Examiner Gross: Prospecting what?

The Witness: Prospecting call, or memorandum.

By Mr. Webb:

Q Was that discussed at the training course as to how to go about making these calls?

A Yes.

Q Do you recall how it was put to you and the others to go about this?

A I don't recall exactly how it was first brought up but I recall the substance of the conversation.

Q Could you tell us how you were instructed -- the substance of the conversation?

A The conversation being the call made to the

prospect?

A Yes, sir.

Q "Hello, Mr. Jones. My name is Larry O'Shea. I'm a stock broker here in Washington with the firm of Hodgdon and Company. Do you have a brief moment?

"The reason I am calling, Mr. Jones, I have a number of clients like yourself who have found our ideas on financial planning not only interesting but very profitable. I am wondering at the present time if you have a good stock broker or investment program."

Depending on that response, I would then ask the prospect whether I could send him our letter on financial planning.

I then I would close the conversation by telling him I would be calling him in a couple of weeks again to see whether or not he had any questions on the contents of our letter.

Q Well, what documents were you supposed to send the prospect?

I think you mentioned a brochure. Any other documents?

A It was suggested a hand-written note, and your business card.

Q In addition to the brochures?

A In addition to a brochure.

Mr. Webb: Mr. Reporter, would you please mark this as Division's next numbered exhibit?

(The document was marked
Division Exhibit 142
for identification.)

(Document handed to Counsel for Respondents.)

Mr. Dickstein: I have just been handed a piece of paper marked as Division Exhibit No. 142 for identification. It has not yet been offered.

This appears to be a written document which contains the text of a proposed initial telephone call.

Mr. Webb has asked the witness to give his best recollection as to what he was told to do while at the same time he had a document in his possession which was the best evidence, and this has been a continuing procedure during the course of these hearings.

I am going to move to strike the testimony, simply because it is now apparent that a document is being offered, and that the document will be the best evidence.

I have no objection whatever to the admission of the document.

Hearing Examiner Gross: Do you have any comment on the objection?

Mr. Webb: Mr. Examiner, I think that not only was the conversation as to how to contact people initially

discussed orally. I think Mr. O'Shea testified that he was given a document by those training those people. I want to introduce the document in addition to his recollection of what he said to customers.

Mr. Dickstein: That was not my understanding--

Mr. Leonard: Assuming there is any merit to the objection at all, it certainly only goes to that part of the evidence which would purport to -- the effort of this witness if he were trying to translate or to state what is in the document.

Hearing Examiner Gross: Let's see the document.

(Document handed to the Hearing Examiner.)

Hearing Examiner Gross: I will overrule the objection but I will ask in the future where such incidents occur-- I don't see that the recollection of this witness and his oral statement on the record of what the contents were actually add anything to the actual document.

Now in this case, the witness was not asked what he said, as I recall, but what he was instructed to say and the document so indicated and actually is the best evidence.

Mr. Webb: I would like to point out, Mr. Examiner, that there was oral instruction also.

Hearing Examiner Gross: Well, I don't recall that, but I think my feelings on the matter are clear and as I said, I will overrule the objection and accept the

document as Division Exhibit No. 142.

Mr. Webb: The witness hasn't seen it,
Mr. Examiner. I haven't shown it to the witness.

Hearing Examiner Gross: If Mr. Dickstein had
no objection --

Mr. Dickstein: I have no objection.

Mr. Hirsch has not seen the document yet.

(Document handed to Mr. Hirsch.)

Hearing Examiner Gross: Any objection, Mr. Hirsch?

Mr. Hirsch: No, sir.

Hearing Examiner Gross: Are you offering it,
Mr. Webb?

Mr. Webb: I would like to have the witness
identify it unless there is no objection.

Hearing Examiner Gross: There is no objection.

It will be received as Division Exhibit 142.

(Division Exhibit 142,
marked for identification,
was received in evidence.)

Mr. Webb: Will you mark these, Mr. Reporter,
as Division Exhibits 143 and 144 for identification?

(The documents were marked
Division Exhibits 143 and
144 for identification.)

(Documents handed to Counsel for the Respondents.)

By Mr. Webb:

Q Mr. O'Shea, I will show you two documents. One has been marked for identification purposes as Exhibit No. 144, and it is entitled "Financial Counselling," dated 1962, and it has four pages.

The other document has been marked for identification purposes as Division Exhibit No. 143. It is another Hodgdon and Co., Inc. brochure. This has seven numbered pages.

I ask you whether you can identify these two documents, sir?

(Handing documents to the witness.)

A These documents are very much like the pamphlet I referred to -- or brochure -- earlier when I discussed sending out our letter on financial planning to a prospect.

Q All right, sir.

Mr. Webb: These documents are being offered into evidence, Mr. Examiner.

Mr. Dickstein: No objection.

Hearing Examiner Gross: Received respectively as Division Exhibits --

By Mr. Webb:

Q I don't believe you mentioned, Mr. --

Hearing Examiner Gross: Just a moment.

-- 143 and 144.

(Division Exhibits 143 and 144, marked for identification, were received in evidence.)

Hearing Examiner Gross: Let the record indicate that both the documents are entitled "Financial Counselling."

By Mr. Webb:

Q Mr. O'Shea, I don't believe you told us who instructed you on approaching new customers?

I believe you discussed the memorandum and how you were to approach a customer, and what you told him. Who was the instructor?

A Mr. Haight.

Hearing Examiner Gross: Who?

The Witness: Mr. Haight, Mr. James Haight.

By Mr. Webb:

Q During the training program, what if anything were you taught about how to deal with new clients with limited means?

A I don't recall anything specific there.

Q Well, in connection with financial planning?

A I think it might help if I point out that the training program that we are speaking about is the first training program. At that time, after a man had been with the firm for a period of time, he would enter into what was

Mr. Dickstein: He used both words at various times and I think he was using them interchangeably. The question is whether or not the company identified these people as to each of these designations.

Mr. Webb: Well, I think your objection --

Hearing Examiner Gross: Go ahead.

Mr. Webb: -- is proper for cross-examination, Mr. Dickstein.

By Mr. Webb:

Q Did you employ any of the services of the experts or specialists that you enumerated at any time?

A Occasionally I did.

Q Who were these people, sir, that you used?

A Well, during the early time of my employment as I recall, I checked with Mr. Haight.

Later on, I occasionally checked with Mr. Adam and occasionally with Mr. Freed.

Q In what areas did you check with these gentlemen?

Let's go to Mr. Haight first.

A Well, as I said, my method of financial planning or writing or presenting a list of recommendations was based on what I had been taught and what I had been able to find out on my own effort. I would come up with a list of recommendations regarding, in certain cases, wills and trusts and investments. These recommendations, before

Mr. Webb: Yes, sir.

Hearing Examiner Gross: Go ahead.

The Witness: Experiences-- I cannot say specifically except that Mr. Freed may know a great deal about taxes and trusts and wills, but I was never able to understand him. I won't say all the time but a good portion of the time, I was never fully able to understand his answer to some of my questions.

By Mr. Webb:

Q Did there come a time, Mr. O'Shea when you attended an additional course given by the Hodgdon firm? I believe you mentioned the advanced course.

A Yes.

Q When did you attend this course?

A In 1961.

Q Until when, sir?

A Until some time in 1962, I believe.

Q Well, how many days a week did you attend, and how many hours a day?

A As I recall, the course was given twice a week for an hour and a half or a two-hour session.

Q Do you recall any of the people that instructed you?

A Yes, sir.

Q Who were they, sir?

We talked about business -- various types of business insurance, corporation insurance. We talked about what is referred to in the life insurance industry, or was referred to as the net cost --

Hearing Examiner Gross: Referred to what?

The Witness: Referred to a sales technique or a plan called, as I recollect, a net cost scheme or plan whereby a person in a high tax bracket buys, let's say, \$100,000 of ordinary life insurance which costs him approximately \$2500 a year. This is the type of life insurance policy where the cash values accumulate fairly rapidly.

After two years, the man can begin borrowing his cash value on a systematic basis and writing off the cost of this borrowing from his income tax and taking the proceeds and buying additional term insurance to make up the borrowed cash values.

In certain cases, it was pointed out that this would be less costly to a high-bracket individual than term insurance or decreasing term insurance.

We also discussed, or Mr. Smith discussed an article which appeared in Kiplinger's magazine called "The Twister's Art," as I recall. That may not be the exact name of the article, but it had to do with life insurance salesmen who, the term is, twists people out of one contract, one life insurance contract, into another one.

And Mr. Smith felt that the article was a good article in that in his opinion there are and were abuses in the life insurance industry.

He pointed out to us-- I believe one of the points mentioned in the article was where a person will buy a new policy to replace an old policy, he would be facing a double expense. A new premium-- He has already paid the expenses on the old premiums. However, he did point out that if the new premium were lower, such as might be the case where an individual is going from an ordinary type of life insurance to term insurance, a type of term insurance, the new premium would be less and, therefore, would not be covered by such an objection.

And as I say, we discussed in some detail the different types of corporation or business life insurance.

Q Well, during these meetings -- and I take it there were four of them with Mr. Smith?

A There were several. I don't know exactly how many without counting them.

Q Well, would you look at your notes and determine how many of these meetings you attended?

A I have eight different meetings recorded.

Q Regarding what?

A Life insurance.

Q Did Mr. Smith, during any of these meetings,

indicate to you that you were to sell life insurance?

A No, sir.

Q Well, what were you supposed to sell, or bring to the attention of a client during these life insurance discussions with a prospect?

A Mr. Smith advised us that where, in our opinion -- which opinion was to be somewhat formulated on some of the points covered by Mr. Smith in these sessions -- that a client of ours or a prospective client appeared to have a great deal of expense in his life insurance, for his life insurance, that we might -- where we also found that this individual was capable of saving in other areas, we mentioned to this prospect that it might pay for him to consider looking into term insurance and mutual funds as opposed to buying only ordinary life insurance.

Q And who would sell the term insurance I think you mentioned?

A Mr. Smith was available for that.

Q For those sales?

A To talk to people.

Q And in fact he sold an insurance policy to a client of yours; is that correct? -- term insurance?

A Yes, sir.

Q What about mutual funds?

Mr. Dickstein: Excuse me, Mr. Webb. The More

Definite Statement does not include the name of Mr. Smith as an individual who advised customers regarding insurance and other matters without suitable training in such fields.

May we assume from the omission that the Division concedes that Mr. Smith did have suitable training in the field in which he advised clients of Hodgdon and Company?

Mr. Webb: As I understand it, Mr. Smith was an insurance agent. I am not saying that Mr. Smith was not trained in insurance. We are just saying that these statements were made by Mr. Smith who was employed by the Hodgdon firm.

Mr. Dickstein: That's find. I just wanted to make sure that that was not the contention.

By Mr. Webb:

Q You mentioned insurance being sold by Mr. Smith, that this would be brought to the attention of clients.

What about mutual funds? What were the mutual funds that would be recommended?

Mr. Dickstein: Are we talking about the training program, or are we talking about something else?

Mr. Webb: We are talking about the recommendations being made by the registered representative to a client. This is during the training program.

Mr. Dickstein: Which training program?

A As far as I recall, yes.

Q Mr. O'Shea, during these sales meetings do you recall being advised as to how to handle cancellations?

A I don't recall which meeting; but at one of the meetings Mr. Carr gave us an idea which related to this particular subject.

Q Would you look at your notes and determine when this meeting occurred?

A There is something here on March 27th.

Q What year, sir?

A 1962.

Q Does that refresh your recollection?

A Yes, sir.

Q What was said by Mr. Carr about cancellations at that time?

A If a client were to call and say he was thinking about cancelling his order, a good way to handle such a situation would be to say "I'm glad you called, Joe. I have been thinking about you. The more I get into this particular situation the more I like it. And I think you ought to double your order."

Q Did Mr. Carr inform you and the group in what situation you would employ this technique?

A As I recall, it would deal primarily with underwritings.

Q Directing your attention to February 26th, 1963, can you tell us whether or not you attended a sales meeting on that date?

A I would have to look at my notes.

Q Would you do that, sir?

A Yes. February 26th?

Q 1963.

A I attended a meeting on that date.

Q All right, sir.

And who spoke at that meeting?

A I would have to look at my notes.

Q Would you do that, sir.

A As I recall, on that date Mr. Hodgdon spoke, Mr. Haight spoke, and Mr. Carr spoke.

Q Do you recall the substance of the conversation by these gentlemen?

A I would have to look at my notes again.

Q All right, sir. Would you do that, please?

A As I recall, on that day some of the things discussed at the meeting: Mr. Carr had a sales idea for us, as follows: An ounce of enthusiasm at the proper time is worth a pound of knowledge.

Mr. Hodgdon talked about leading a -- what is the best word here? -- leading a rational type of life and taking things one at a time, or one day at a time.

Also, Mr. Haight discussed obtaining one sales ticket a day. And Mr. Hodgdon added that it is very easy to make a game of obtaining orders for buying or selling stock.

Q Did you say "game"?

A Yes, sir. For instance, if you were a client of mine I might call up and say "Harold, I haven't made any money today. Why don't you buy something?"

Basically that is what I recall of that meeting.

Q All right, sir.

Regarding the statement by Mr. Carr about what you testified to, did he explain that phrase in any more depth? -- the purpose of it?

A Not that I recall.

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Q Do you recall attending a sales meeting in which Mr. Carr spoke about reasons for selling securities or having customers sell securities?

A I would have to look at my notes.

Q Would you look at your notes, please, sir? .

A I recall.

Q What date?

A March 27th, 1933.

Q And what did Mr. Carr say about that topic?

A Some of the reasons Mr. Carr advanced for a client's possibly selling or buying securities were as follows:

Having too much of one stock or one company;

Not having enough of one company;

Tax loss selling;

Lack of diversification, having all of the money you have invested in only two or three securities;

Comparing the yield on a real estate syndication with the income from a stock or group of stocks;

Checking to see what the advisory services are recommending, for instance, Standard and Poor's, what the mutual funds are selling.

These are some of the reasons I recall.

Q Do you recall any other reasons?

A Not without looking at my notes.

Q Will you look at your notes and tell us what other reasons, and how many reasons in all were given.

A Fourteen reasons were given.

Some of the other reasons given were:

What fits into the five best industries, the five greatest growth industries, perhaps?

Too much of one industry;

Giving stock to a child for college;

Selling on good news;

Up-grading a portfolio.

Q All right, sir.

Now my question was the reasons for selling a stock, and you also mentioned the buying of stock.

Could you refresh your recollection by looking at the notes to determine whether these were merely reasons for selling a stock?

A The heading is "Reasons for Selling a Stock".

Q All right.

Mr. Dickstein: Has the witness changed his answer, that these were reasons for both selling and buying securities?

Hearing Examiner Gross: I'm in a little doubt, too. What were these reasons supposed to represent? Reasons for buying or reasons for selling, or both?

The Witness: I think it is a combination. You

Mr. Dickstein: Or an incorrect statement of fact.

Hearing Examiner Gross: The ruling stands.

Answer the question.

The Witness: No.

By Mr. Webb:

Q During the time that you were employed by the Hodgdon firm, what research facilities did that company have? Could you describe it as best you can recall?

A We had a financial library which was available to the representatives.

Q Could you describe this, if you can?

A Well, the library contained Standard and Poor's Corporate Records, the Wisenberger Investment Advisory Service, the Sidney Freed Warrant Letter, the Value Line Service. Those are some of the publications that I recall that the library contained.

Q Was there anyone designated as a research man during your time there at the Hodgdon firm?

A Not that I recall.

Q Well, who did the research?

A When you say "research" --

Q Well, who would research the individual securities that a representative might be interested in?

A The representative.

Q In connection with financial planning, would you

Hearing Examiner Gross: Your best recollection.

Strike "frequent" and "infrequent".

Mr. Dickstein: It hasn't been described what the witness would regard as frequent or infrequent.

Hearing Examiner Gross: We struck those words. We are merely asking for his best recollection.

The Witness: I would say occasionally.

By Mr. Webb:

Q On the securities that were not listed on the Exchange, could you describe the commission sale that was to be made on these securities?

A Well, on an over-the-counter security, you could mark up lower priced securities as much as 5 percent, and higher priced over-the-counter securities 3 percent or 2 percent, if that answers the question.

Q Let me see if I can refresh your recollection.

Mr. Dickstein: He didn't indicate that his recollection needs refreshment. He answered the question.

Hearing Examiner Gross: Well, as a question without --

By Mr. Webb:

Q Well, sir, do you recall any specific securities that were recommended that you described and the commission sale on them that were not listed -- that were over the counter?

of that amount, which in terms of dollars and cents would be, again sticking with the example of a \$10 stock, and let's take a figure of 40 percent of \$16. Your salesman's commission would be-- Let's see. Forty percent of \$16 is \$6.20--some I believe, whereas if you were getting 5 -- getting 2-1/2 percent of an over-the-counter commission, or mark-up as it is called in our industry on a \$10 stock, you would -- your commission would be \$25.

Mr. Dickstein: I would like to move to strike that answer on the grounds that there is no allegation in the order for public proceeding that the registrant engaged in the practice of charging unreasonable mark-ups. I do not see to what this testimony relates other than such a claim.

Mr. Webb: Mr. Examiner, the Division is obviously not charging unreasonable mark-ups, but rather attempting to show what the inducements were to selling out of the inventory as opposed to selling listed securities.

Mr. Dickstein: Is it the Division's position, then, that this testimony goes only to show that there is a higher commission on over-the-counter securities than there is on listed securities? If so, we will stipulate that.

Mr. Webb: I want the testimony to show it.

Hearing Examiner Gross: I will take it.

Go ahead.

Mr. Dickstein: Can the question be confined to underwriting or non-underwriting issues?

By Mr. Webb:

Q Securities that were sold out of the trading account of the Hodgdon firm?

A Of the securities I mentioned, as I recall, there was a commission to the representative on Drew Properties, Transcontinental Investing, and Primex, of one-half of a dollar.

Q Do you recall the price at which they were being sold to the public at that time? The price range?

A In the neighborhood of \$8 to \$11.

Q Was that higher than the commissions to be made on listed securities?

A Yes, sir.

Q Do you know how much higher?

A Well, I believe the commission for a \$10 stock on the Exchange is-- Talking about the salesman's commission now?

Q Yes.

A The commission is approximately \$14, \$15, \$16 the client pays, and depending upon the brokerage firm, the salesman's portion of that \$15 to \$18 -- I don't recall exactly what the commission is for a hundred shares of a \$10 stock on the Exchange -- would be 30 to 40 or 45 percent

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Mr. Webb: I want the testimony to show it.

Hearing Examiner Gross: I will take it.

Go ahead.

By Mr. Webb:

Q Would you tell us the circumstances of your leaving the Hodgdon firm, Mr. O'Shea?

A I resigned on April 1st, 1964, after having a discussion with Mr. Haight.

Q Would you tell us of that discussion, sir?

A Mr. Haight had called me in to his office the afternoon of April 1st, and had asked me why I hadn't sold my indication, which indication, as I recall, was for five shares of Roseville Detroit, and I told him I didn't like the issue.

He asked me why I didn't like it, and I explained to him why I didn't like it.

Q What did you tell him as to why you didn't like it, sir?

Mr. Hirsch: Objection. I think the reason why Mr. O'Shea didn't like the issue is irrelevant to this proceeding.

Hearing Examiner Gross: Yes, I will take it.

Go ahead.

The Witness: Answer the question?

Hearing Examiner Gross: Yes.

The Witness: Well, I told him that in my opinion as I understood the mechanics or the financing of the issue, while 9 percent appeared to be the return to an investor,

unlike many of our other syndications, an investor would not build up any reasonable equity in the property, because as I recall there was, in addition to a first mortgage, there was a second mortgage which had a large payment at the end of a term of years, and again in my opinion I foresaw the curtailment of the first mortgage to the extent where, if refinancing were obtainable in seven or eight or nine years, the new money coming to the partnership would have to be used to pay off the second trust.

Therefore, I did not like it primarily for that reason, plus at the time GEM International's latest balance sheet, or the one -- the latest sheet that was available, as I recall, showed current assets and current liabilities of approximately the same amount.

And Mr. Haight said to me, "What's wrong with a guaranteed 9 percent?"

And I answered his question with a question, "What's wrong with the First National Real Estate Trust?"

And at that time, Mr. Haight became excited, and by that I meant, "What's wrong with putting my clients into that as opposed to Roseville Detroit?"

Mr. Haight then became excited, jumped from his seat, and told me that the firm had never -- had never not sold anything it had undertaken to sell, and that the firm was going to sell this, and that further, he wanted a list

this proceeding?

A Yes, sir.

Q By the way, do you recall the publication of a supplement to this list?

Mr. Webb: Can the witness look at the document so he knows what you are talking about?

(Document handed to the witness.)

The Witness: I recall receiving something in addition to this pertaining to this subject.

By Mr. Dickstein:

Q Wasn't this list of preferred mutual funds expanded to include some 30 or 35 mutual funds?

A I don't recall exactly, but that list there has quite a few funds on it.

Q Well, this list has 15. Do you recall publication of an additional list about equal in length?

A I recall receiving another memorandum --

Q But you don't know how many additional mutual funds were on this?

A No, sir.

Q Did anybody at Hodgdon and Company ever tell you why they had a list which they referred to as preferred mutual funds?

A I believe so.

Q Who was it, and what reasons were given?

A As I recall, Mr. Hodgdon, or Mr. Carr, perhaps both, discussed the preferred mutual funds, and it was pointed out, as I recall, that were a brokerage house such as ours, such as Hodgdon and Company, sold a substantial portion of a particular fund or funds shares, that such a firm would be given some of the business which the particular fund or funds managements had to offer.

By that I mean every mutual fund from time to time buys and sells securities, a practice in the mutual fund industry which continues to go on as far as I know, and which was going on at that time.

Q You are referring to the practice called reciprocals?

A Yes, sir.

Q By the way, how do you know it still goes on?

A The firm I worked for most recently, Swan, Lacey and Michnick, which was previously Mitchell, Swan and Lacey, would receive reciprocal business from time to time from mutual funds.

Q Weren't those reciprocals received by Swan, Lacey and Michnick in proportion to the amount that they sold in a particular fund, or are you suggesting that they would receive additional multiples of reciprocals if they got over a certain minimum level?

A I don't know exactly what formula, if any, was

Q Were indications given publicly and openly during these meetings?

A I don't believe so.

Q In what form do you believe the indications were given?

Mr. Leonard: I object. I think he ought to tell us what he recalls as being said and done.

Hearing Examiner Gross: Mr. O'Shea, I don't know when you say you "believe" you mean whether you recall.

The Witness: That is what I mean, sir.

Hearing Examiner Gross: But if you mean that you recall, you will have to say so.

The Witness: Go ahead.

By Mr. Dickstein:

Q In what form do you recall that indications were given on Roseville Detroit?

A On slips of paper.

Q Was the giving or taking of indications from representatives the usual company practice on underwritings?

A Yes, sir.

Q Had it been the consistent practice from the time you became associated with the firm?

A Yes, sir.

Q Had you yourself given indications with regard

looking into a stock situation when he asked me if he could look over my portfolio and I said he could, he seemed very interested in my financial status.

Q All right. At that time, before you actually opened the account with the Hodgden firm and Mr. Harper, did you have another broker?

A Yes, I had.

Q Who was that broker?

A Robert Garrett of Baltimore, Maryland.

Q Do you remember when you first spoke to Mr. Harper about opening an account with him in this firm, approximately?

A I would say early 1931.

Q Where did you actually talk to him?

A In our home.

Q Who was present.

A My son was present, any number of times. At other times it was just myself and Mr. Harper.

Q As best you can rec all, what did Mr. Harper tell you in early 1931 about opening an account with his firm?

A That I would have expert advice and I would not have to be concerned about stocks and bonds, because I knew nothing of them, and that he could do that for me, that they specialized in estate planning.

Q In about early 1931 what was your approximate net worth?

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Getting new customers-- I believe you testified you used the Yellow Pages, is that correct?

A Yes, sir.

Q Did you call people from the Yellow Pages?

A Yes, sir.

Q Did you get new customers?

A At that time to get new customers, yes.

Q Did you know these people in the Yellow Pages?

A No, sir.

Q Did you make sales of securities to these people from the Yellow Pages?

Mr. Dickstein: I'm going to object to this unless he identified the portion of this 3,000-page book I think he is referring to.

Hearing Examiner Gross: Overruled.

The Witness: Ultimately I did to many of them, yes, sir.

By Mr. Webb:

Q Did you make attempts to make the 40 calls a day as proscribed by Mr. Haight?

A Yes, sir.

Q Were you friendly with the other members of the class in the training program?

A Yes, sir.

Q Do you know how and who -- how they attained

new customers?

A As I recall most of them used a list of names. I don't know-- I don't believe any others in my group used the Yellow Pages.

One fellow used a telephone directory, as I recall, of -- oh, I think it was the Bureau of Weapons or some Government agency with a name like that. I don't know what the other fellows used, or how they went about getting their --

Q Were you familiar or did you-- Were you friendly with other members of the Hodgdon group who were not in the class?

A Yes, sir.

Q Do you know how other individuals obtained lists or what lists they used?

A Well, another friend of mine used the Yellow Pages. Two or three other fellows were using the Yellow Pages. Some fellows used, I believe, directories of different Government agencies.

Q Do you recall any of the Government agencies in addition to the Bureau of Weapons?

A I don't believe so.

Q Now, with respect to the use of the David L. Babson Company, the investment advisors, I believe you testified that you were instructed to advise clients who

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had large portfolios to use the services of this company;
is that correct?

A Well, they should investigate the services, yes.
They might investigate it, if these individuals did not like
the concept of some money in mutual funds, and some in these
other areas.

Q Can you tell us how large a portfolio one would
have to have before the David L. Babson Company -- before you
would advise them to use this service?

A As I recall at the time, David L. Babson had
a minimum figure of \$50,000 in a portfolio, or moneys to
be invested.

Q Were you given from time to time a memorandum
from the trader, Mr. Piper, as to securities that were
being sold or being offered by the Hodgdon firm out of its
inventory?

A I believe so.

Mr. Webb: Mr. Reporter, will you mark these
five memorandums from the Hodgdon firm as one separate
exhibit, next numbered exhibit, which I believe is Exhibit
153.

(The documents were marked
Division Exhibit 153
for identification.)

Mr. Dickstein: I might as well indicate now that

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if these are offered I am going to object to them, and I am also going to object to any questions on them as being improper in redirect.

By Mr. Webb:

Q I believe you indicated that you received as a salesman for the Hodgdon firm periodic memoranda regarding sales of securities that were being recommended, including mutual fund recommendations.

Mr. Dickstein: Objection on the ground stated; that this is improper redirect.

Hearing Examiner Gross: Read the question back.

(Whereupon, the Reporter read from the record as requested.)

Hearing Examiner Gross: Overruled.

Answer, please.

The Witness: We did receive weekly memoranda.

By Mr. Webb:

Q All right, sir.

I will show you five such memoranda. The first one is dated September 14th, 1962.

The second one is dated April 15, 1962.

The third one, September 17th, 1963.

The fourth, January 29th, '63.

The fifth, January 31st, 1964.

(Handing documents to the witness.)

I ask you, sir, whether you can recognize or identify any or all of these documents?

A I remember receiving copies of some of these.

Q Do you know which ones you received, sir, or see which ones you saw, rather?

A I believe I received copies of all of them, but specifically --

Hearing Examiner Gross: Mr. O'Shea, we talked about this word "believe". Now either you recall or you don't recall.

The Witness: I'm sorry.

I recall seeing three of them. I know I received three of them, and I recall receiving the other two.

By Mr. Webb:

Q All right, sir.

Mr. Webb: I would like to offer this particular exhibit into evidence, Mr. Examiner.

Mr. Dickstein: Objection as being improper on redirect.

Hearing Examiner Gross: Overruled.

Received as Division's Exhibit 153.

(Division's Exhibit 153,
marked for identification,
was received in evidence.)

By Mr. Webb:

Q Now, in connection with these memoranda, I would like for you, sir, to tell us in connection with the memorandum dated January 31st, 1964, which is a part --

Hearing Examiner Gross: Would you withhold your question for a moment?

I would like to look at all of them before you go on to see what you are talking about.

(Documents handed to the Examiner.)

By Mr. Webb:

Q In connection with the memorandum dated January 31st, 1964, sir, there is a list of securities, the quote, the commission and the shares.

I ask you, sir, will you please explain the commission schedule on this?

(Document handed to the witness.)

For example, Primex Equities, selling quote 9 to 10; commission 1; shares, 1,000.

Would you explain that so we can all understand this particular document, and the rest of these documents?

Mr. Dickstein: May it be understood that I have a standing objection?

Hearing Examiner Gross: On the basis of improper redirect?

Mr. Dickstein: Yes, sir. If I have another ground I will state it particularly.

The Witness: Regarding Primex Equities, the quote listed here is \$9 bid and \$10 asked or offered. This is an over-the-counter security, and as far as I can tell, this is a price as of January 31st, 1964, and at this time the commission being paid is -- As I recall, the salesman would divide or split the commission listed here.

For instance, a dollar is listed here, and the salesman would earn 50 cents per share, and at this time there were a thousand shares.

By Mr. Webb:

Q A thousand shares where, sir?

A Oh, I believe the-- They were in what the company referred to as "in position".

Q Inventory, you mean?

A I believe that is the same thing.

Q All right, sir.

And this explanation would hold true for all the other securities listed on these various memoranda; would that be correct?

A (No response.)

Q The overall explanation?

A I would say so.

Q Now directing your attention to the memorandum dated January 29th, 1963, in regard to the mutual fund commissions to representatives on the first page, there is

looking into a stock situation when he asked me if he could look over my portfolio and I said he could, he seemed very interested in my financial status.

Q All right. At that time, before you actually opened the account with the Hedgden firm and Mr. Harper, did you have another broker?

A Yes, I had.

Q Who was that broker?

A Robert Garrett of Baltimore, Maryland.

Q Do you remember when you first spoke to Mr. Harper about opening an account with him in this firm, approximately?

A I would say early 1931.

Q Where did you actually talk to him?

A In our home.

Q Who was present.

A My son was present, any number of times. At other times it was just myself and Mr. Harper.

Q As best you can rec all, what did Mr. Harper tell you in early 1931 about opening an account with his firm?

A That I would have expert advice and I would not have to be concerned about stocks and bonds, because I knew nothing of them, and that he could do that for me, that they specialized in estate planning.

Q In about early 1931 what was your approximate net worth?

A Yes.

Q Did there come a time in August 1961 when you had a discussion with Mr. Harper as to your investment objectives and as to how your account would be handled? August of 1961?

A I told him, at the time, I told Mr. Harper at the time I would have to rely on his advice. I knew nothing of stocks or bonds or how to best handle that. And I knew that they specialized in estate planning, so he told me to let the worrying be up to him. He would take --

Q Excuse me. Do you recall talking to him in August of 1961?

A Yes, because he knew that I was a worrying person.

Q What else do you remember of that conversation, and where did it take place, by the way?

A In my home.

Q Who was present?

A As best I can recall, I was there alone. There were other times when my son was there, but the exact date, whether it was August 1961 that he was present, I do not know.

Q Let me see if I can help you recall.

Hearing Examiner Gross: Mr. Webb, at first blush,

this looks like three copies of the same list attached to this exhibit. Is that what you intended? Isn't one enough?

Mr. Webb: They may have been put together inadvertently.

Hearing Examiner Gross: You better check it to be sure.

Mr. Webb: You are right, Mr. Examiner. Would you mark this?

(Whereupon, the document referred to as Division Exhibit 155 was marked for identification.)

Mr. Dickstein: Mr. Examiner, these exhibits appear to be photocopies of the documents, as they were in the files of Hodgdon & Company. That is copies of these. Is that correct?

Mr. Webb: Some of them are; some of them are not.

Mr. Dickstein: I see. I mention that simply because these pencilled notations apparently did not originate from Mrs. Daffin. I recognize the documents have not been offered with them, but it might be confusing.

Hearing Examiner Gross: I think the record is clear with respect to the notations.

By Mr. Webb:

Q Mrs. Daffin, I show you Division Exhibit 156 marked for identification. This is a two-page letter, apparently from you, and it says, "Wednesday, August 23."

I ask you whether you can identify that particular document. Please read it to testify.

A Yes. I wrote that letter to Mr. Harper.

Q What is the year on that letter, Mrs. Daffin?

A 1961.

Q Does that letter refresh your recollection as to the conversation you had with Mr. Harper in your home?

A Yes, it does, indeed. I had so many conversations, I just don't remember exactly what a particular event was. But I do very definitely recall that.

Q Directing your attention to that conversation with Mr. Harper in August 1961, what do you recall about that meeting at this time, looking at the letter now?

Q I recall that Mr. Harper submitted a plan which involved the sale of roughly 25 or 35 stocks that I held, which I felt was a very major undertaking

He felt that they were very low yields, overpriced, and that I should move into things that were less risky than the ones I held.

Q Anything else?

A I felt that I had to have every reassurance that --

Mr. Dickstein: Objection.

Hearing Examiner Gross: Sustained. Just tell us what was said, please.

The Witness: Oh, yes.

By Mr. Webb:

Q Do you recall telling him that?

A Yes, I recall telling him that this was all I had, and that I had to play it very safe and be very conservative. I had been brought up to be a conservative person and had always had conservative stocks, and those were the kind I insisted on having in the future.

Q Do you recall what he told you?

A He told me not to worry, that he would do the worrying for me.

Q Anything else?

A Not at this particular time, I don't recall.

Mr. Webb: I offer Division Exhibit 156 into evidence.

Mr. Dickstein: No objection.

Mr. Siegel: No objection.

Hearing Examiner Gross: It is received as Division Exhibit 156.

(Whereupon, the document referred to

above as Division Exhibit 156 was

received into evidence.)

a span of four years, two of which are outside of the scope of this proceeding.

Hearing Examiner Gross: All right. This question is allowed. Go ahead. The objection is overruled.

By Mr. Webb:

Q Do you recall approximately when you spoke to Mr. Harper in connection with that letter?

A Shortly after that time.

Mr. Webb: I would like to point out that I would have asked these questions and we would have saved all of this laboring on the record.

Hearing Examiner Gross: Go ahead.

By Mr. Webb:

Q What do you recall of this conversation as best you can remember? I believe you testified you were concerned and so forth. What did Mr. Harper tell you?

A That I would make a great mistake if I would make any effort to get out of that program because it had a very fine potential, it had quite a value, and would, over a period of years, possibly go up to 2010 and --

Q The year 2010?

A Yes. And I could realize from this maybe \$125,000 or as much as \$250,000.

Q What?

A Dollars.

Q . In what form? Appreciation or income?

A Returns, returns from the oil, you know, money gotten from the oil program, that I would benefit from.

Q Well, after this discussion did the Apache program continue to assess you?

A Yes.

Q Was this an assessment above and beyond the \$2500 which you previously testified to?

A Yes.

Q Can you tell us what assessments were levied in 1962, 1963 and 1964?

A 1962, \$5,200; 1963 I haven't totalled them, 5-6-63, \$2,400; 8-1-63, \$1,800. That is for the year.

Q What about the year 1964?

A 1964, 1800 was paid.

Hearing Examiner Gross: 1800 what?

The Witness: \$1800 was paid in assessments for 1964. And after that time I stopped paying because I didn't feel that I could continue on being assessed. And it was suggested that I finance it with the promise of returning to me \$100 a month from the oil.

By Mr. Webb:

Q Confining yourself to the year 1964, up until that time how much had you invested in the oil program?

A To date?

Q Up until 1964?

A Oh, approximately \$18,000.

Q All right. \$18,000?

A Yes.

Q Prior to your subscribing to the Apache Canadian oil program in 1961, had Mr. Harper informed you of the additional assessments which you did pay?

A Not as I recall.

Q During the --

A \$5,000 was supposed to be it, as far as I was concerned. When I got into the others, I didn't know what to do then.

Q During the period of these additional assessments from 1961 to 1964 did you inform Mr. Harper of your concern regarding the situation?

A Yes, I did. I wanted to sell it.

Mr. Webb: Would you mark this as Division exhibit for identification 163?

(The document was marked Commission exhibit 163 for identification.)

By Mr. Webb:

Q Mrs. Daffin, I show you a letter handwritten with your address stamped thereon dated July 10. It has been marked as Division exhibit 163 for identification. I ask you whether you can identify this particular letter?

A Yes, I wrote that letter to Mr. Harper.

Q What is the year on the letter?

A As best I recall, it was after I received a telegram from them.

Q When was that?

A It was in December 1962.

Hearing Examiner Gross: Who is "them"?

The Witness: From the Apache Oil. They sent me a letter of greetings.

Mr. Webb: I offer in evidence Division exhibit 163.

Mr. Dickstein: What is the date of this letter?

Hearing Examiner Gross: July 1962.

Any objection?

Mr. Dickstein: No objection.

Mr. Siegel: No objection.

Hearing Examiner Gross: It is received as Division exhibit 163.

(The document previously marked Commission exhibit 163 for identification was received in evidence.)

By Mr. Webb:

Q Do you recall whether or not you spoke to Mr. Harper subsequent to the time that you wrote that?

A Oh, yes, certainly I did. I showed him some of the

things they sent me.

Q What did Mr. Harper tell you?

A He told me I would be making a great mistake to get out of a program that was so valuable to have. I was very lucky to be a participant.

Hearing Examiner Gross: Is this a conversation that occurred after the letter was written?

By Mr. Wobb:

Q Approximately when did this conversation occur as best you can remember?

A It happened many times, every time I would get an assessment. But this one --

Q Yes. Approximately when did you talk to Mr. Harper after you sent that?

A After that, I would say several weeks afterwards.

Q Do you recall anything else about the conversation?

A I don't quite understand your question do I recall anything else about the conversation. I am sorry.

Q Was there anything else said in addition to what you just testified to?

A I don't --

Q As a result of the conversation you just testified to, did you continue your oil program and its assessments?

A Yes, I did.

Q Now I believe you testified regarding the financing

of this. When did the financing take place?

A The latter part of 1964.

Q This is in regard to financing the oil program?

A Yes.

Q Could you tell us the circumstances, why you had to finance it?

A Number one, I did not have the money to finance it, it was taking it away from other things I needed; and number two, I didn't feel it was any program for me to be in.

Q Do you recall Mr. Harper evaluating the worth of your Apache 1961 Canadian program?

A He had done that on any number of occasions in that portfolio analysis that he made up for me two or three times a year. He even, as I recall, wrote me one time where he had some anxious buyers for it.

Mr. Webb: Would you mark this Division exhibit 164 for identification?

{The document was marked Commission exhibit 164 for identification.}

Mr. Webb: Would you also mark this as Division exhibit 165 for identification?

{The document was mared Commission exhibit 165 for identification.}

By Mr. Webb:

Q Mrs. Daffin, I show you a letter from Mr. Harper dated January 8, 1963. This is a photocopy, and there are 10 pages in all.

I ask you whether you can identify this particular document?

A Yes, I can identify that. That was prepared for me by Mr. Harper.

Q How did you get that document?

A As best I can recall, by mail.

Q Now there are various penned notations throughout this document. Were they on the document when you received it?

A No, they were not at that time.

Mr. Dickstein: Is that also true of the lines striking out certain of these items?

The Witness: Mr. Harper, when he talked with me later on, would say "There is a mistake" or something, or he would make his figures on the side. That is when we had a personal conference.

Hearing Examiner Gross: At the time you received that, were any of the ink notations on there?

The Witness: Oh, no, sir.

By Mr. Webb:

Q On page 3 of Division exhibit 164 for identification,

Mr. Scigel: No objection.

Hearing Examiner Gross: Received as exhibit 166.

(The document previously marked
Division exhibit 166 for identifi-
cation was received in evidence.)

By Mr. Webb:

Q Mrs. Daffin, on the first page next to Canadian Gas and Oil Program 1961, with respect to the value which is in parens, there is \$24,210, and that has been scratched out, and next to it there is a notation of what appears to be \$35,000.

Can you tell us about that?

Mr. Dickstein: The copy that was handed to me does not have penned notations on it.

The Witness: That is Mr. Harper's writing. He had told me all along the program was worth \$35,000, he had several buyers that would pay that for it, that I was making a great mistake to sell it for \$35,000.

By Mr. Webb:

Q Because of the value of \$35,000?

A Yes.

Q Was that notation on there when you received that letter?

A No, it was not. He wrote it in there when he came to visit me.

Q Do you remember anything else about that discussion?

A I do not.

Q What about the other notations on the back, the second page?

A That one?

That was \$25 received from the Lord of the Flies. He put that in there. That is Mr. Harper's handwriting.

Q When did he put that in there?

A When he came to see me.

Q What about the other notations on the bottom of the second page?

A It says "Money owed to bank," and the interest. I was paying interest on a bank note.

Q What was the discussion about that?

Mr. Dickstein: Can we find out when the notations were placed on this?

Mr. Webb: During a visit by Mr. Harper.

Hearing Examiner Gross: How soon after the receipt of this letter, do you recall?

The Witness: Fairly soon after I received this analysis, when he visited me. It could not have been too many days, maybe a week or so.

By Mr. Webb:

Q What did he say about interest? Did he explain that notation?

A Well, the interest to the bank wasn't too greatly discussed because I knew what interest I had to pay.

Q What interest are you referring to, on what loan?

A I am referring to a loan, a bank note that I took out, it is not a loan, it is a bank note, it was a note that I took out for my son's magazine and then down there it says, it looks like "shares of Nocturne".

Q That refers to your son's magazine?

A Yes, it does.

Q Was there discussion at that time about your son's magazine?

A Well, there had been for some time.

Mr. Dickstein: The copy that was handed to me also contains the handwritten notation on page 1 "For Bob Owens, CPA."

Does that appear on the copy in evidence?

Mr. Webb: No, it does not.

By Mr. Webb:

Q Do you recall that notation being on the original document, "For Bob Owen"?

Hearing Examiner Gross: Mr. Dickstein, would you show your copy to the witness and let's ascertain whose handwriting it is.

Mr. Dickstein: Might I suggest we mark this copy for identification as 166-A? That is, the copy that

lived in?

The Witness.. No.

By Mr. Webb:

Q Did there come a time when you had a discussion with Mr. Kitain in his office at the Hodgdon firm?

A Yes.

Q Do you recall when that occurred and what was said, if you recall?

A Well, it was January or February of 1961.

Q Who was present?

A Mr. Kitain and myself.

Q What was discussed as best you can remember?

A Well, he had analyzed the investment portfolio. He felt that it was more conservatively invested than was necessary for someone such as myself who was not dependent on the portfolio for income and that I could pursue a more aggressive policy, although I was not interested particularly in speculative issues.

Q Did you tell him that?

A Yes.

Q What was the plan he outlined to you, as best you can recall?

A Well, he felt -- of course my problem has been that in the foreign service we are moving around rather -- my husband is in the foreign service -- and we had

moved around considerably, and we needed -- well, I was somewhat bothered by the necessity to make a lot of decisions about a subject, that is investment, on which I was ill-informed and which I found it difficult to keep myself informed on under these conditions. He felt --

Q Who felt?

A Mr. Kitain felt that the stocks in this portfolio, many were of doubtful quality, and that I could improve, I could solve this management problem by putting the bulk of the portfolio into mutual funds, where you have a built-in managerial function.

Q What did he tell you about mutual funds?

A Well, the two funds that they recommended, that he recommended were Aberdeen and Putnam Growth. Aberdeen as a high quality relatively conservative fund --

Q Is that what he told you?

A Yes. And the Putnam Growth as one which had a better growth picture and which he felt offered better opportunities for capital gains. He felt that a more growth-oriented portfolio was desirable, since I wasn't particularly interested in the income, and that the tax rate on a growth portfolio would be less.

Q What did he tell you about how much to invest in these funds?

A Well, he wanted to see the bulk of the portfolio

of Wise Homes in October, 1961 at \$5 and three quarters cents per share?

A Correction, 265 shares?

Q 300 shares?

A Yes, I do.

Q Do you recall purchasing another 265 shares of Wise Homes at \$4.25 per share in November, 1961.

A Yes, I do.

Q Upon whose recommendation were these shares purchased?

A Upon whose recommendations were those shares purchased?

A Upon the recommendation of Mr. Adam.

Q Well, what were the circumstances of your purchasing the additional shares in Wise Homes in late 1961?

A For the same reason, to average the cost down, because the stock had depreciated in value.

Q Well, what explanation had Mr. Adam given you about buying stock on the down side, so to speak?

A Well, he told me that they had a contact in North Carolina who informed them that the company was, in spite of the fact that the stock had gone down, that it was still a good buy.

That is the best information they had to give me, and I decided after Mr. Adam recommended to purchase some additional shares to average the cost down.

was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Leonard:

Q Will you state your name?

A Eleanor W. Clay.

Q Where do you live?

A 3322 Slade Court, Falls Church.

Q Where are you employed.

A Department of Agriculture.

Q Directing your attention to the year 1958, were you employed at that time by the Department of Agriculture?

A Yes, I was.

Q Do you recall when it was that you first had any contact with anybody from Hodgdon & Company?

A It was in 1958, at my office.

Q Do you recall when in 1958 that was?

A Not exactly.

Q Do you have any notes that would refresh your recollection?

A Yes, may I consult them?

Q Would those notes refresh your recollection?

A Yes.

Q Then would you look at them please.

Mr. Shapiro: May we inquire as to the time of the notes?

Q What is your best recollection, as to what happened after you discussed it with your husband as to that?

A That during the telephone conversation I gave Mr. Haight permission to purchase 50 shares.

Q Was this the conversation before you discussed it or the conversation afterward?

A After I talked with my husband.

Q Do you recall whether it was a phone call you directed to Mr. Haight or one he directed to you.

A I did not direct it to him.

Q Do you have any recollection whether that conversation was directed to you at home or in your office or otherwise?

A That I cannot say for sure.

Q At that particular time that you spoke or at the time, after you discussed it with your husband and talked with Mr. Haight about it, did you have any other information, other than what he told you over the telephone?

A No.

Q Did Mr. Haight ever disclose to you the fact that Van-Pak could not be sold in the State of Virginia?

A No, not to my knowledge.

Q Did you subsequently receive a confirmation and a prospectus for Van-Pak.

A Yes, I did.

Mr. Shapiro: If you want to put it in, I have no

A I think it was approximately 1959. I don't have the exact date.

Q Who was your registered representative.

A Mr. Lyles Carr.

Q In connection with that, do you recall whether or not you were ever contacted by Mr. Carr with respect to a stock called Van-Pak, Inc.?

A Yes, I was.

Q Do you recall approximately when that was?

A It was in the early part of 1962, I don't know the exact date.

Q How were you contacted.

A Telephonically.

Q Do you recall where you were contacted.

A Not specifically, no. I don't know whether it was at home or at the office.

Q What did Mr. Carr say, if anything, in this telephone conversation to you about Van-Pak?

A Well, he described the type of company it was, mentioned it was containerised freight forwarding, or something like that, primarily in the business of forwarding household goods in containers. I don't recall the exact words. But he indicated to me that he felt that this was one of the most promising issues that had come to his attention, and that he thought it couldn't miss, thought it would be a good stock to

A Yes, I did.

Q Did you also receive a prospectus?

A Yes, I did.

Q Do you recall whether or not you directed the check in payment of the transaction prior to or at the time or subsequent to receiving the confirmation and prospectus.

A As I recall, it was at the time I received the confirmation and prospectus.

Q Did Mr. Carr ever disclose to you that Van-Pak could not be sold in the State of Virginia?

A No, he did not.

Q Did he ever discuss that subject matter with you at any time?

A No, sir.

Q Do you recall whether or not you read or examined the confirmation?

A Oh, I am sure I did. I don't recall specifically, but I am sure I did when I received it. Because normally I would receive a confirmation and then I would send a check to Hodgdon & Company.

Mr. Leonard: There being no objection to the previously identified documents, I offer them into evidence as Division's Exhibits 218-A through D.

Hearing Examiner Gross: 218-A through D are so received.

A Excuse me. I think I made a mistake. Change that from 1,000 shares to 200 shares. I'm sorry.

Mr. Timmeny: Would you read back the question I just asked.

(The pending question was read.)

The Witness: Mr. Guy Kibler called me at my home.

By Mr. Timmeny:

Q Where was your home at this time?

A 2946 Torrey Place, Alexandria, Virginia.

Q During this phone conversation with Mr. Kibler did he tell you about Van-Pak?

A He told me there was a new stock which he had and he was calling certain clients relative to purchasing of such stock. He mentioned at the time that the company was engaged with government contracts in overseas hauling and transportation of household goods in a new form of container.

Having recently left the armed forces, and being acquainted for many years with the problems, I at the time thought this was an excellent idea, and thought any company that would pack its household goods in containers might be worthwhile to look into.

Q What was said, if anything, about Van-Pak's financial condition?

A Nothing whatsoever.

Q During this discussion did Mr. Kibler tell you that a sale of Van-Pak in Virginia would be in violation of the securities laws in the State of Virginia?

A No, sir.

Mr. Dickstein: Objection.

Hearing Examiner Gross: Objection overruled.

By Mr. Timmeny:

Q Answer the question.

A No, sir, he did not.

Q During this discussion did Mr. Kibler inform you that the securities were not registered in the State of Virginia?

A No, sir, he did not.

Q Did you order Van-Pak during this discussion, this phone conversation?

A Yes, sir, I did.

Q Did you receive a confirmation of your purchase?

A I received a confirmation and a prospectus, I believe, at the same time.

Q And this was after your phone conversation?

A After the phone conversation.

Mr. Timmeny: Mr. Reporter, I ask that you mark this document as Division exhibit next in number for identification.

and everybody would be happy and I could just go along and I felt better that we just did.

Mr. Dickstein: Would you read that answer back for me?

(The answer was read by the reporter.)

Mr. Webb: Is that legible, Mr. Examiner?

Hearing Examiner Gross: Yes.

By Mr. Webb:

Q Mrs. Daffin, you were shown a letter dated August 4, 1964, from Mr. Harper to you and which is already in evidence as Respondent's Exhibit Lk, and Mr. Dickstein questioned you regarding some of the pen notations on the first page of that document.

A Yes.

Q I would just like to get your best recollection on the pen notation to the left. There is the figure 13,221, and it is right next to Capital Properties, and to the right of the page next to 6.6 percent on the Canadian Gas and Oil Program there is figure \$35,000. Can you tell us again what those figures represent as best you can recall?

A As best as I remember, it was after a conversation when we went over my portfolio.

Q Who went over the portfolio?

A Mr. Harper went over it with me, and Mr. Harper said the program was valued at \$35,000. That is the one to the right.

just answer Counsel's question?

The Witness: Very well.

By Mr. Leonard:

Q I think my question was:

During that period, what was the volume of mutual funds that you sold?

A I would say approximately, during that period in particular, approximately 50 percent.

Hearing Examiner Gross: Fifty?

The Witness: Yes.

By Mr. Leonard:

Q And what portion of your sales related to real estate limited partnerships?

A Most of the remaining portion of it was real estate. A very small percent of it was devoted to anything else other than real estate or mutual fund shares.

Q Do you recall whether or not there came a time when as a registered representative you began receiving any memoranda or aids with respect to selling securities which the firm had underwritten?

A Yes, sir.

Q When was that? What period of time was that?

A Beginning I believe -- and this is to the best of my recollection -- around the middle or the first of 1960, we began to receive memoranda at our Tuesday morning

meetings about securities that were in inventory that we had underwritten and there would appear at the top of the list, at the top of the sheet, a list of securities, the number of shares available, the price, and the commission.

Q Are you familiar with the commission scale on the sale of securities listed on the New York Stock Exchange?

A Yes, sir.

Q In relation to your knowledge of the securities commission listed on the New York Stock Exchange, what was the scale of commissions that appeared on these memoranda that you speak of?

Mr. Dickstein: Objection.

Hearing Examiner Gross: Sustained.

By Mr. Leonard:

Q What was the rate of commission on the New York Stock Exchange, do you recall?

A Well, the rate of determining the commission on the New York Stock Exchange is relatively complicated and yet very simple but it depends upon the number of shares and the number of dollars involved. I believe under \$300 it is one-half of one percent plus \$3, and you go on up from there to one-tenth of one percent plus \$39.

Q And was the rate of commissions on the memorandum of which you speak on recommended securities greater or lesser than the listed securities?

Mr. Dickstein: Objection.

Is the memorandum available?

Mr. Webb: Yes, we have it.

Mr. Dickstein: Some of the memoranda are also in evidence, but I also object on grounds of relevancy.

Mr. Leonard: Well, this is taken in connection with the overall factual presentation to show that these were higher and of course, we would argue from that --

Hearing Examiner Gross: They are in evidence and it just remains to be argued.

Mr. Leonard: All right, sir.

By Mr. Leonard:

Q In these Tuesday morning meetings, with what regularity, if any, did you receive this type of memoranda, sales memoranda such as you discussed?

A To the best of my recollection, beginning around '61, they appeared almost every Tuesday with varied amounts and various securities that were offered for sale.

Q Do you recall whether or not on such memoranda listed securities ever appeared as recommended?

A No, sir.

Mr. Dickstein: Objection.

Hearing Examiner Gross: Sustained.

By Mr. Leonard:

Q Do you recall on how many occasions, if any, you

received any oral instructions recommending sale of listed securities?

A I don't remember ever having received any written instructions on the recommendation of any listed securities. However, at one time there was interest in the firm on some New York Stock Exchange stocks. I believe the one the firm became quite interested in is the one known as Philadelphia-Reading which is listed on the New York Stock Exchange.

Q During the period of your employment at Hodgdon and Company, what is your recollection as to the amount of listed securities that you recommended and sold to customers?

A My portion of the business done in listed securities was insignificant.

Q I want to direct your attention now to the method of obtaining new customers. Do you ever recall discussing the method of obtaining new customers with anybody in Hodgdon and Company?

A Yes, sir.

This was one of the basic fundamentals in my training course, the method of obtaining new clients.

Q Who generally discussed that?

A Generally Mr. Carr.

Q Do you recall that anyone else other than Carr would do this?

number of questions regarding what I was doing at that time in the way of employment, what my background was, where I was from. Mr. Hodgdon asked no questions about my family, where they lived, what they had done and what they were doing at this time.

Q Well, do you recall what he said about the Hodgdon philosophy at that time?

A The best I can recall, he discussed the Hodgdon philosophy in terms of a financial planning approach that they used, meaning, as I remember, an all-encompassing approach to helping an investor with his finances.

Q What do you recall of the conversation with Mr. Haight?

A The best I can recall the conversation with Mr. Haight, Mr. Haight discussed the financial planning concept used by Hodgdon and Company. He discussed some of the plans that they had for a representative. He discussed the fact that they were commencing a new training program soon and that, the best I can recall, he also discussed that they were very unique in the business in their financial planning, their financial planning concept.

Q Well, how did he explain that, the uniqueness of the Hodgdon firm?

A Well, the best I can recall of the interview with Mr. Haight in his discussion of the uniqueness of the financial

Hodgdon firm, to take additional notes?

A Yes.

Q Could you explain your note-taking for those occasions?

A Well, each Tuesday morning we had staff meetings, at which I took personal notes. We had additional lectures in training programs, at which I took notes. We had subsequent sales meetings in which I also took personal notes.

Q Could you describe your note-taking on those occasions, sir, as to what you put down and how you put it down and where you put it down, briefly?

A On the other occasions, in addition to the initial training program, the notes I took were on personal stationery, personal paper or personal notebooks, at which time I attempted to record the things which I considered important or which were emphasized as being important parts of the particular lectures.

Q Well, do you have all the notes that you described this morning here with you today?

A I have most of them, yes.

Q All right, sir. Now, during the initial training program, what was your instruction regarding the methods of developing contacts?

A During the initial training program, the best I can recall, we were instructed on how to prospect and we were instructed that we would be code-canvassing, code-prospecting,

and we were instructed, the best I can recall, to use the telephone for the most part in our code-canvassing and code-prospecting.

Q Who instructed you on the methods of contacting new customers, as best you can remember?

A The best I can remember, Mr. Knight.

Q Do you recall whether or not he told you at that time as to how many calls a day a new employee should make?

A Yes.

Q What was that, sir?

A Forty phone calls a day.

Q And did you make the forty phone calls a day?

A Yes.

Q What about personal interviews? Did he go into that?

A Yes.

Q Can you tell us about what he told you about personal interviews?

A Mr. Knight, in the training program, instructed us on personal interviews with a prospect, instructed us how to make presentations.

Q I am just trying to get at as to how many interviews you were to conduct a day, not the methods.

A We were expected to have two appointments a day.

Q Do you recall, in making telephone calls, your forty calls a day, when you were supposed to make these calls?

A May I refer to my notes?

Hearing Examiner Gross: If that will refresh your recollection.

The Witness: I'd like to use them to refresh my recollection.

Hearing Examiner Gross: All right.

The Witness: Yes.

By Mr. Webb:

Q Tell us now, sir, have you refreshed your recollection?

A Yes. In referring to my notes to refresh my recollection, the times which we were advised to make these forty calls was between 9:30 and 12 and 1:15 and 4:15.

Q Was it A.M. or P.M., or what?

A 9:30 A.M. to 12 Noon, and 1:15 P.M. to 4:15 P.M.

Q Did you follow those instructions?

A Yes, for the most part.

Q Do you recall at what day or the month that Mr. Haight instructed you on this particular subject?

A Well, in looking in my notes to refresh my memory, the instruction on this was on or about October 10, 1961.

Q Do you recall what, if anything, Mr. Haight said about direct mail approach?

A Well, the best I can recall, Mr. Haight did not express the lack of enthusiasm for this type of prospecting.

Q What do you mean by that, sir?

By Mr. Webb:

Q I believe the last question, Mr. Saffer, concerned itself with the special situation being mentioned in the lecture on the ratio system given by Mr. Haight. Is that correct?

A Yes.

Q Could you tell us what Mr. Haight said about the ratio system and the special situation definition, after referring to your notes and refreshing your recollection?

A Well, looking at my notes, there is a reference made to speculations and special situations, but I don't recall exactly what was said about special situations.

Q Do you recall what was said about speculations, now that you have refreshed your recollection by the notes?

A Well, in using my notes to refresh my memory, speculations were defined, as best I can recall, by a corporation that can stand on its own merit and has a potential kicker.

Q Could you explain the word "kicker"?

A I don't recall the meaning of it, as used back then.

Q All right, sir. But you do recall the term being used?

A In using my notes to refresh my memory, yes, I have reference to it in my notes.

Q All right, sir. In connection with the subject of sales techniques, can you tell us what your instructions were regarding the approach or the presentation to be used in a

two questions, how he approached and how he was instructed. If it means how he was instructed I have no objection.

Hearing Examiner Cross: No, how he was instructed.

Go ahead.

The Witness: The instruction we were given, as best I can recall, was in making a sales presentation to a prospect, and in using my notes to refresh my memory, during the training program at various times sales techniques and ideas were explained to us and we, near the end of our training program, were expected to have developed from the lectures that were given in the training program an actual sales presentation that would be used when having a face-to-face interview with a prospect. We were to give this presentation in a live fashion in the training session. Therefore, I took from my notes, according to the best I can recall, I took from the notes that I had written down in my notebook during the training program and made an actual sales presentation from the instruction that was given. And we were instructed on having a face-to-face interview with a prospective customer in introducing the fact that we at Hodgdon and Company performed a unique investment service for our customers which we called financial planning. And we were further instructed to explain to the prospect in this initial interview that we had a number of services available to him, and we were instructed to cite the particular services which were available, such as bonds,

corporate securities, and insurance specialists, real estate investment trusts, real estate syndications, new issues or underwritings, oil and natural gas programs, specialists on trusts, and on occasion we underwrite Broadway plays. And we were further instructed, after making this phase of the presentation, that we should make to the customer a presentation concerning a balanced "T" concept --

Hearing Examiner Gross: A balanced what?

The Witness: A balanced "T".

Hearing Examiner Gross: "T"?

The Witness: "T", yes, sir. A balanced "T" concept which embraced the philosophy of one having 50 percent of his assets in fixed assets and the other 50 percent in equities. And we were further instructed to tell the client in this initial interview that, in handling the equity side of the balanced "T" concept, that we would suggest a ratio system to help him reach his financial objectives, the ratio system being the previously referred to 50 percent professional management, 30 percent blue-chip stocks, growth stocks, real estate trusts, real estate syndications, and 20 percent speculations.

By Mr. Webb:

Q Do you recall anything else about the instruction given in this area?

A Well, the best I can recall along these lines, we were instructed as to how to get an agreement from the prospective

customer that there was a need for investing and to obtain from him a response on whether or not this philosophy sounded like something that could be sensibly employed by him.

Q Do you recall whether or not this approach or instruction was broken down into various phases?

A I don't follow the question.

Q Do you recall what, if anything, was said as to the various stages of the development of the approach? Was it broken down into categories? Would your notes serve to refresh your recollection?

A Yes. In looking at my notes to refresh my recollection, the presentation was broken down into the approach phase, the phase of creating an interest on the part of the prospect. It was further broken down into a conviction phase, and finally in a closing phase of the presentation.

Q The closing phase being the actual selling of the plan or the particular security?

A No, sir.

Q Well, could you explain what you mean by "close"?

A Well, the best I can recall in regards to the presentation, the close would be in obtaining from the prospect certain information on a confidential financial data sheet.

Q Well, in other words, that was what this approach was aimed at?

Mr. Dickstein: Objection.

Hearing Examiner Gross: Sustained. What was the third phase, Mr. Saffer?

The Witness: The third phase was the conviction phase.

Hearing Examiner Gross: Yes.

The Witness: To the best I can recall.

By Mr. Webb:

Q Did you actually make a presentation which you have just described, during the training course?

A Yes, sir.

Q Can you, as you best can recall, give us that presentation?

A Yes. I could give it. I could probably give it according to the best I can recall.

Q Would you do that, sir?

Hearing Examiner Gross: To whom was it given?

The Witness: Specifically I don't recall. It was given to another member of the class, with the other member of the class being the prospect.

Hearing Examiner Gross: Go ahead.

By Mr. Webb:

Q Will you give us that presentation, sir?

A Mr. Jones, I am John Saffer of Hodgdon and Company. I am happy to be here today to tell you about our investment philosophy which we consider is rather unique. It's something

we call financial planning. And in our financial planning services, we offer such things as insurance, corporate bonds, corporate securities, mutual funds or investment company shares, new issues or underwritings, real estate syndications, real estate investment trusts, oil and natural gas programs, and occasionally we underwrite Broadway plays. And also on our staff we have people that are specialists in taxation, trusts, and profit sharing.

Of course, Mr. Prospect, it's inconceivable that you could use all of those investment services, but there is a possibility that you may like to make more than one available to yourself. And we feel that we can help you in this regard. Do you have any questions concerning any of these particular services that I have just mentioned?

Well, Mr. Prospect, we feel that there is a definite need for investing today because of some very appalling statistics that have been released by the U.S. Government, namely, that 75 percent of the people that reach retirement age today do not have enough money to live on to sustain a type of living in which they had been exposed to prior to retirement. And with this appalling statistic being revealed in this, the wealthiest country in the world, we feel that there is a definite need for financial planning or investment planning. Would you agree with this, sir?

Now, we use at Hodgdon and Company what we call the

balanced "T" concept. The balanced "T" concept would be whereby we think it's sensible that 50 percent of your money, 50 percent of your assets, should be placed in fixed assets, such as Social Security, insurance, bonds, savings and loans, other types of savings, credit unions, Social Security, but that the other 50 percent should be placed in equities, equities meaning something that has an opportunity to grow, such as corporate securities, mutual funds or real estate.

Mr. Prospect, does this sound like it's something that would be a sensible investment approach to you?

Now, of course we, at Hodgdon and Company, are more interested in the equity side of the investment program and we feel that we have a rather unique way of handling this particular aspect and we call this particular approach the ratio system. The ratio system would consist of putting 50 percent of your money under professional management, 30 percent in blue-chip stocks, growth stocks, growth real estate investment trusts, real estate syndications, and 20 percent in speculations.

We feel that this is a sensible approach to investing, in that under professional management we feel that you have one of the most sensible and less expensive ways of investing in securities.

And we also feel that if we invest your money properly in the 80 percent area, namely, the 50 percent professional

management and the 30 percent under corporate securities and real estate, that we could have a total loss in the 20 percent area and still not be deterred from reaching our investment objective, in reaching your particular goal.

How does this sound to you, sir? Does this sound like a sensible approach?

Well, before I can make any specific recommendations to you, there is certain information that is necessary.

That is the end of the presentation.

Q Well, what would happen after that, when you asked the information, for information?

A Well, we were provided with and instructed on how to use a confidential data sheet and at the end of this sales presentation we would ask the customer certain questions that appeared on a confidential data sheet.

Q What was your instruction regarding the purpose of the confidential data sheet?

A The instruction, the best I could recall, was to obtain the information, obtaining the answers to the questions on the confidential data sheet so that the information could be studied and so that a financial plan could be worked out for the investor.

Q What information would be necessary for the data sheet?

A The best I can recall, information regarding the

investor's age, his number of dependents, his employment, his tax bracket, his insurance program, his potential retirement benefits, his income needs from an investment program as projected at a retirement age, information on his insurance program, information on his real estate holdings, on his cash savings and money in bonds, information on his corporate securities, whether or not he had a will, if there were charitable contributions and other miscellaneous information that might be important.

Q Mr. Saffer, who was the instructor in the area that you just testified about?

A The best I can recall, it was Mr. Haight.

Q Well, could you tell us whether or not this approach was to be used in canvassing all new prospects face-to-face?

Hearing Examiner Gross: Read the question back.

(The last question was read back by the reporter.)

The Witness: The best I can recall, yes.

By Mr. Webb:

Q This was the instruction given by Mr. Haight?

A The best I can recall, yes.

Q Okay. Did there come a time, Mr. Saffer, when you were given an instruction on how to overcome objections that a prospective client might have?

Mr. Dickstein: May we have the time, circumstances and the speaker?

Mr. Dickstein: Is the witness looking at a document now to refresh his recollection?

Hearing Examiner Gross: Are you, Mr. Saffer?

The Witness: Yes, sir.

Mr. Dickstein: May I see it?

Hearing Examiner Gross: Pass it to Mr. Dickstein.

Mr. Dickstein: Thank you. Go ahead, Mr. Webb.

By Mr. Webb:

Q What was the first step idea?

A Idea magic was defined, according to the best I can recall, was in selling ideas, and not particularly selling a product; the second step of the nine was to stop overcoming objections but to use the customer's objections to help to make a sale rather than as a barrier, to more or less join the prospect in his feelings and his objections about a particular project.

The third one was that five appeals only would be sufficient.

Q What were those five appeals, Mr. Saffer, as best you can remember?

A Well, the best I can remember, they were to appeal to the prospect's sense of fear, to his sense of fear, appeal to his sense of greed, appeal to his sense of prestige; I can't recall the others.

Q All right, sir. Go on to the next step, as best

was explained was that we should feel confident and superior, but do so in a subtle manner, and always know more about our particular product and the products than the prospect or the customer did. And the ninth step was to be always in fighting trim, meaning to be in good physical and mental condition.

Q All right, sir. Did we get who the instructor was, to your best recollection?

A I think I mentioned that, yes.

Q Who was that?

A The best I can recall, that was Mr. Haight.

Q All right, sir. Did there come a time, Mr. Saffer, when you were given instruction on the convictional stage of a presentation in some detail? The conviction stage?

A Yes.

Q As best you can remember, can you tell us what was said, who said it, and approximately when it was said?

A The best I can recall this, the instruction on the conviction phase of the sales presentation was given in 1962. And the best I can recall, it was given by Mr. Haight and it consisted of instruction that for each fact that we presented about a particular product we should also give the customer a benefit.

And we were further instructed to only give the facts that are of interest to the particular prospect, to give the facts that were pertinent or that are necessary to support

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our presentation.

And using my notes further to refresh my memory, we were also instructed to never give all the facts in the conviction phase of the presentation. And we were further instructed to ask questions in the pre-approach phase of the sales presentation so that we would be able to conduct the conviction phase of the presentation in a more satisfactory manner.

Q Such as? Would you, go ahead, sir.

A Such as by finding out the needs and the wants and the particular desires and the particular interests of the prospect.

Q Go on, sir?

A And we were further instructed to use a bridging technique in presenting the facts and then relating these particular facts to a benefit that could be derived by the customer, bridges such as, according to the best I can recall, such as "when you owned this", "which will mean", "therefore", "this means", and "because of this you will".

Q All right, sir. Go on, please.

A And we were further instructed on this particular aspect regarding the nail-down. By that, according to the best I can recall, it was meant that we should obtain an agreement or an acceptance on each one of the major facts and points about the conviction phase of the interview by

memory, I do recall additional instruction by Mr. Carr.

By Mr. Webb:

Q What was that additional instruction, as best you can remember?

A As best I can remember, the instruction by Mr. Carr was the citing on his part of several reasons to convince someone to sell a particular security.

Mr. Dickstein: May we see the notes to which the witness is referring?

Hearing Examiner Gross: Yes.

Mr. Dickstein: Thank you.

By Mr. Webb:

Q Could we go over those reasons, sir?

A I am sorry.

Q You testified that Mr. Carr enumerated certain reasons in which to convince a customer to sell. Could we go over those reasons?

A Well, in using my notes to refresh my memory, the reasons that we were given were to explain to the customer that he might be too heavy in one stock, that he had too large a percentage of his money in one particular security, and to go on and explain to him along these lines, that the institutions don't have this large a percentage in any one particular company, and to go on and ask him if he can afford to take such a loss if something should happen to the particular company that he

had a heavy percentage of his securities in.

Another reason that Mr. Carr gave was to show the customer, or say to the customer that he has such a small amount of money in one particular stock that it really won't make that much difference if the security would double or triple in value. In other words, it wouldn't make the customer rich.

Q Well, what else about that point do you recall?

A So that Mr. Carr went on to instruct us along these lines, to the best that I can recall, that the customer should either sell this small holding or buy more of it.

And a third reason that we were instructed on was to explain to the customer the advantages of a tax loss in that the customer, in taking a tax loss, would be able to write it off against his taxes and therefore absorb some of the loss this way.

The fourth reason that Mr. Carr cited, according to the best I can recall, was if the customer was in a situation where he had a large paper loss on the stock, we were instructed to explain to the customer how he could sell the stock and, if he liked it, to buy it back thirty-one days later and thereby use the loss as a tax deduction.

A fifth reason Mr. Carr cited was to explain to the customer that he has too much of his money in one particular industry, and thereby unlike a lot of the institutions that

were diversified over many industries to keep their risk down, that this wasn't a very prudent thing to do.

Mr. Carr went on to instruct us that we might advise the customer to give away some of his securities to someone, friends, a child, and have the particular minor sell the securities so that the funds could be used to finance education, etc.

The seventh reason that Mr. Carr cited to us was that in cases where a person might own a great deal of the company stock of the company which he worked for, and he went on to explain to us that a customer might own too much of his own company's stock and even though he was working for them, this may not be a prudent move.

Another reason that Mr. Carr cited to us at this particular meeting was to advise the customer that it might not be a bad idea to sell on good news in certain cases because, as Mr. Carr instructed, the odds against it going up are rather small and that this, as Mr. Carr instructed, may be the time when the professionals are getting out of the security.

Another reason that Mr. Carr cited was that we might inform a particular customer when the institutions were liquidating a stock, when they were getting out of it, to tell the customer about this and use this as a reason for selling.

Q What about -- Go ahead, sir, I am sorry.

A And another reason that he went on to use was to

follow the advice of Standard & Poor and Value Line in regards to selling certain securities, and explain these to the customer.

Q Do you recall any others?

A Oh, yes. In looking at my notes to further refresh my memory, Mr. Carr went on to instruct us to determine with the customer whether or not this particular security would fit into one of the top five growth industries, and Mr. Carr went on to explain to us that we might use, as a reason to sell, the suggestion that a person upgrade his portfolio, that he seek more quality in his investments, and thereby eliminate some of the lower grade issues.

Q Do you recall any others, sir?

A No, sir. I don't think so.

Q What about the ninth suggestion given by Mr. Carr?

Mr. Dickstein: Objection.

Mr. Webb. Mr. Examiner --

Mr. Dickstein: It's the clearest form of leading.

Mr. Webb: Mr. Saffer was enumerating numbers and I think he skipped one.

Mr. Dickstein: He may very well, but this is as much leading as if Mr. Webb wrote it down on the blackboard for him.

Hearing Examiner Gross: Sustained.

By Mr. Webb:

Q What, if anything, was said about comparing rental houses with apartment houses to learn equity positions, etc.?

A Well, in using my notes once again to refresh my memory, Mr. Carr instructed us on comparing rental houses with apartment projects to learn of the equity position that an investor might have in the project and to determine the rate of return that was being received so that the investor could compare his investments with the ones that Hodgdon and Company offered.

Q All right, sir. I think, Mr. Examiner, can we take a break? I am also very hungry.

Mr. Dickstein: May we make it long enough?

Hearing Examiner Gross: I see the witness' hunger affecting us. Did you want to say something?

Mr. Dickstein: Yes, sir. Despite the fact everybody is hungry, I don't think I will have time because I have been handed this jumble of papers. May we have a somewhat longer luncheon recess than is normal so that I can try to make sense out of these things?

Hearing Examiner Gross: What are they?

Mr. Webb: Let the record reflect that these are copies of the notes in unasssembled form which were voluntarily reproduced and given to counsel for the respondents, and which are not junked material.

Mr. Dickstein: These apparently are the notes or

The Witness: No, I am afraid without using my notes to refresh my memory I wouldn't be able to recall specifically.

Hearing Examiner Gross: All right, you may use your notes.

The Witness: On using my notes to refresh my memory, Mr. Carr spoke at the staff meeting on April 9, 1963, regarding real estate syndication, and the best I can recall he instructed us on how to go back, converse with a prospect who had not taken a real estate syndication or the best I can recall the instruction was what to say to a prospective prospect who would cancel a particular real estate underwriting order. And Mr. Carr's instruction, as I recall, was to reply to the customer, "What, cancel? It is all sold out. This is such an attractive deal I think you ought to take more of it," or words to that effect.

Then he went on to instruct us we should ask the customer what the problem was, why he wanted to cancel.

By Mr. Webb:

Q Do you recall whether or not, Mr. Saifer, you followed such advice?

A No, I don't recall specifically whether I ever used it.

Q Do you recall anything else that Mr. Carr spoke about at that meeting?

A The best I can recall, I remember an instruction like this being given more than once while I was at Hodgdon and Company, and once again, the best I can recall, I believe the instruction was given by Mr. Haight and Mr. Carr.

HEARING EXAMINER GROSS: Did you say and or or?

THE WITNESS: And.

BY MR. WEBB:

Q Mr. Saffor, can you tell us whether or not you were present during a staff meeting on or about May 26, 1964, during which time Mr. Carr spoke on Southeastern Mortgage Investors Trust?

A Independent of my notes, I can't, but may I refer to my notes to refresh my memory?

Q Yes, please do.

(Pause.)

Have you refreshed your recollection, sir, after reviewing your notes?

A Well, in looking at my notes to refresh my memory, I do recall a meeting at this time at which Mr. Carr spoke.

Q Can you tell us now you have refreshed your recollection, what Mr. Carr said at or about that time?

A Mr. Carr instructed us on the selling of Southeastern Mortgage Investors Trust and the best I can recall he suggested that we should make a list of prospects and making a list of those, putting them in such order that those we felt we could

1 sell first and easiest being first on the list. And he also
2 indicated in the meeting as best I can recall that we ourselves
3 should be sold on the particular investment, should be convinced
4 of its merits. And also the best I can recall, Mr. Carr in-
5 structed us that we should find the easiest money first, such
6 as savings and loan money, cash value of life insurance policies.
7 And, best I can recall, Mr. Carr instructed us that we should keep
8 our comments to the customer in a simple fashion, uncomplicated
9 tone.

10 Q Anything else that you can recall, sir?

11 A Best I can recall, Mr. Carr further instructed us to
12 try to be enthusiastic when we were selling it and say to the
13 customer that would be a check coming in each month and we would
14 certainly like to see him get it.

15 Q All right, sir.

16 A That's the best I can recall.

17 Mr. Dickstein: I do not appear to have the notes
18 which the witness has been using to refresh his recollection.

19 May I see a copy of it, please?

20 (A copy was handed to Mr. Dickstein by the witness.)

21 Mr. Dickstein: Thank you.

22 Hearing Examiner Gross: What are we waiting for?

23 Mr. Webb: I thought, I was waiting for counsel to look
24 at the notes.

Hearing Examiner Gross: He already has.

Hearing Examiner Gross: All right. Answer yes or no. Were recommendations made that you sell special securities within the specific areas while you were at the Hedgdon Company?

The Witness: Yes, sir.

Hearing Examiner Gross: All right.

Go ahead.

By Mr. Webb:

Q How were these recommendations brought to your attention?

A I am not clear as to exactly where you would like me to correct my -- I don't quite understand this --

Q There were various securities brought to your attention for recommendations to your clients, is that a correct statement?

A Yes.

Q How were these recommendations physically brought to your attention. We have gone over staff meetings --

Hearing Examiner Gross: Were you given lists of these recommendations in writing?

The Witness: Yes, from time to time we were.

Mr. Webb: All right.

Would you mark this Mr. Reporter.

Mr. Dickstein: Does the witness understand this question refers to lists of recommendations which would go within

different way than Mr. Webb used the word client and yet because the answer to one is addressed to the question involving client the record is confused.

Hearing Examiner Gross: Do you consider someone who does not follow these recommendations of yours but who would buy isolated securities through you, is this a financial planning customer?

The Witness: No, sir.

Hearing Examiner Gross: Did Mr. Johnson follow any plan with you in the purchase of securities?

The Witness: Not specifically, no sir.

Hearing Examiner Gross: Any plan of any kind?

The Witness: Specifically, no, sir.

Mr. Dickstein: I mention this because Mr. Saffer's notes indicate the word client was used as a term of art at Hodgdon & Company. At least so he was instructed.

Mr. Webb: What is a term of art?
I would like to know.

Hearing Examiner Gross: Let's ask him.
In preparing your notes, did you use the word client to mean something special, something different from the word customer?

The Witness: Yes, sir. As I recall, in my initial months of employment at Hodgdon & Company in my initial training, three types of relationships were defined. As I recall, one was that of an account which would morely be someone

who gave us orders to buy and sell through us. That of a customer as I remember, would be someone who would follow our recommendations in part whereas a client, as I remember it being defined to us, would be someone who would follow the financial planning program as designed and outlined.

By Mr. Webb:

Q The client he is the one who followed the financial planning?

A Yes.

Q All right.

Now, getting back to Division Exhibit 284, the last page, there is the handwritten notation of the initial H. Do you know how that came to be put on that page?

A This, as I can best recall and perceive, is the initial of Mr. Haight.

Hearing Examiner Gross: Mr. Saffer, the question is: do you know how that initial got there?

The Witness: Well, as I best recall, the initial was placed here after the final summary had been composed as an endorsement to be carried to the particular customer.

Hearing Examiner Gross: Did you get a copy of this letter for your personal files after it was sent?

The Witness: I believe I did, yes, sir.

Hearing Examiner Gross: Do you recall the initial on your copy?

tions and/or carefully analyzed speculations.

Q This 50-30-20 recommendation, in this case, was it so-called standard recommendation that was employed by Hodgdon and Company and taught during your training program; was it not?

A That is the way I remember it, yes, sir.

Q Here we have four proposed plans in which one out of four of the recommendations is for the 50-30-20 ratio. Was that about the same percentage of overall plans during the time that you were at Hodgdon and Company in which you employed the 50-30-20 ratio as expressed in the Bahry letter?

A I have no recall as to whether or not that was the proper ratio of using the 50-30-20.

Q Let me express it differently.

Here we have four plans and, in one out of four, we find the 50-30-20 ratio. If we examine all of the plans that you proposed to your clients or prospective clients, during the time that you were employed at Hodgdon and Company, would we find approximately one out of four employing the 50-30-20 ratio?

A I couldn't answer that specifically. I would say that the best I can recall that the percentage employing the 50-30-20 ratio would probably be higher.

Q How much higher than one out of four?

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notes.

Mr. Dickstein: Do you find the note of that particular lecture?

Mr. Webb: I have the notes. They are in evidence, Mr. Dickstein. There are five, Exhibit 260, past recollection recorded.

Mr. Dickstein: Thank you. I was mistaken.

By Mr. Dickstein:

Q Are these the notes you wish to use to refresh your recollection, Mr. Saffer?

A I would like for clarification, because I am not certain that I testified to the fact that I attended a lecture by Mr. Haight in which he lectured on five different appeals. I recall looking at these notes and, as I remember, making certain statements surrounding these notes, under which Mr. Haight, as I said, I could best recall, lectured on five points concerning a sales presentation.

Mr. Dickstein: May we have this marked for identification, please?

(Whereupon, the document referred to above was marked as Exhibit CCCC for identification.)

By Mr. Dickstein:

Q Mr. Saffer, would you identify Respondent's

Exhibit CCCC for identification for us?

I am referring to the portion beginning, "NINE Sales Steps." Were these notes that you took of a lecture?

A As I can best recall, they were, yes, sir.

Q By whom?

A As I best recall -- I don't recall specifically who conducted this particular lecture.

Q What was the occasion of the lecture?

A I don't remember.

Q The date appears at the top, January 22. Could you tell us what year that was?

A I couldn't say specifically, no.

Q But these were notes taken by you during the course of the lecture?

A Yes, sir, as I can best ascertain, that is the case.

Q The third category under the "Nine Sales Steps," reads: "Five appeals only will work."

Did the speaker enumerate those five appeals?

A I don't remember.

Q Do you recall what was said on that, or any other, occasion, as to the five appeals that should be employed in selling?

A Well, yes, sir, as I can best recall, other

instruction on the appeals that could be used in selling, the appeals as I best remember them, were appeal to fear, appeal to greed, appeal to fear of inflation, appeal to fear of loss -- I can't remember what the fifth one was.

Q Weren't the appeals to fear of inflation and appeals for fear of loss variations or subheadings under the appeals to fear?

A I don't remember specifically.

Q You testified on direct, did you not, that one of the basic appeals was appeal to prestige?

A Yes, sir, I think I did. I think I remember that as being one of the appeals that we were instructed on.

Q Do you remember the other two of them? That is, other than appeals to fear, appeals to greed and appeals to prestige?

A No, I can't recall.

Q Did you ever employ an appeal to prestige in approaching a prospect or discussing a prospect's potential investment in a security?

A I could not remember specifically, no.

Q Did you ever hear the term, "appeal to status," used as another way of describing appeal to prestige?

A Yes, sir, I seem to recall that was used.

Q Did you ever employ an appeal to status in dis-

cussing securities or investment planning with a client?

A I don't recall whether I used it specifically or not.

Q Would you give us an example of an appeal to greed, as you used it, in approaching or discussing securities with a client?

A Well, an approach that could be used, as I best remember some of the instruction that I followed in appealing to greed was --

Q Tell us what you actually said, Mr. Prospect, and so on?

A I don't remember actually or specifically what I said, in that I don't think I had a specific or candid approach that I used without exception.

Q You mean you have no recollection of ever using an approach which you characterized as an appeal to greed?

A No, sir, I don't think I intimated that.

Q Have you ever heard the term, "hope of gain," used as the equivalent for the appeal to greed?

A Yes, sir.

Q Did you ever use it -- the "hope of gain" as a talking point in discussing securities or securities investments with your clients?

A Yes, sir, as I recall, I did.

Q Could you tell us what it is you said?

A Well, as I best recall, one of the examples that I had used in appealing to the prospects hope of gain was in showing the comparative results of a particular amount of money invested over the past ten years in a mutual fund versus the results over the same period of time in a savings and loan.

Q Was that something that you were told to use under the category of appeal to greed?

A As I best remember, that was one of the examples that we were instructed could be used, yes, sir.

Q And did you use it?

A Yes, sir, I believe I testified that I did use it.

Q Could you recall any other examples of appeal to greed?

A To try and best answer that question, I would say, in showing the performance of various investments over a past historical period of time was used in appealing to the greed of a prospect or a customer.

Q Such as showing what the result of 100 monthly investments in a selected mutual fund would have been over the course of the last 20 years?

A Yes, sir, that would be an example.

Q Was that appeal to greed which was recommended to you at Hodgdon and Company?

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A Yes, sir, as I remember it and understood it, it was.

Q Did you employ that particular appeal?

A Yes, sir, as I best remember, I did.

Q Do you remember any other recommended approaches, sales approaches, to a client which came under the heading of an appeal to greed?

A Well, independent of looking at notes, I can't recall any others at this time.

Q If I showed you notes which appear to describe a fully developed sales approach to a client, might this assist you in refreshing your recollection as to what other appeals to greed you were taught to employ at Hodgdon and Company (handing to the witness)?

Has your memory been refreshed, Mr. Saffer, as to any other examples of appeals to greed?

A There is one other that the notes refresh my memory on and that is concerning the real estate syndications at Hodgdon and Company.

Hearing Examiner Gross: The what?

The Witness: Real estate syndications.

By Mr. Dickstein:

Q What was that?

A Well, that was whereby it could be explained to a prospective customer, as I recall, that the real estate

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offerings would pay somewhere around eight to ten percent, partially tax sheltered.

Q And that was another example of an appeal to greed?

A Well, as I understood it, at that time, as I best recall it, it was, yes, sir.

Q I am not challenging you, Mr. Saffer, I am merely asking you if that is the case? Is your answer yes?

A My answer is as I stated it.

Q Does that fully exhaust your recollection of the appeals to greed that you were taught at Hodgdon and Company?

A Well, I remember that there was some instruction on comments made concerning speculative issues and underwritings, special situations, concerning the fact that, if they were successful, there might be a hope for large capital gains.

Q Does that fully exhaust your recollections as to the appeals to greed that you were taught at Hodgdon and Company?

A I can't recall any others at this time.

Q Do you recall employing any other appeals to greed, other than those to which you have already testified?

A No, I don't recall instruction on any others, employment of any other, other than the two I testified using.

Q Did reading that document serve to refresh your recollection as to some or any of the appeals to prestige that you were taught at Hodgdon and Company?

A Yes, sir, I think it did.

Q Could you now recall some of those appeals to prestige?

A Well, the one that I can best recall, after looking at those notes, was the -- as I remember -- the instruction that, if a person followed a financial planning program and met with success, that, during his later years, as he neared retirement or approached retirement years, he would have the satisfaction, the security of having built up an investment program that could be used for his benefits at that time.

Q And that was an appeal to prestige that you were taught?

A As I best remember it, yes, sir.

Q Did you employ that appeal to prestige?

A As I best recall, I did use it, yes, sir.

Q What examples of appeals to fear were you given at Hodgdon and Company?

A As I best remember, the appeal to fear that we

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were instructed on was that of the loss of purchasing power of individuals' money through the effect of inflation.

Q Could you tell us how you would make that appeal to a client or prospect? What did you say?

A Well, the instructions we were given and that I employed, as I best remember it, was citing the price of various consumer items, such as a car, loaf of bread, or Coca Cola, or home, in 1940 versus the current price today.

Q And you did this with your clients?

A Yes, sir.

Q Could you recall any other examples of appeal to fear that you were taught to employ at Hodgdon?

A Well, as I best recall, there was instruction on explaining to a customer that there could be a loss sustained by placing an excessive amount of money, as relating to this situation, in one security. I explained through lack of diversification that there might be the possibility of sustaining losses.

Q Did you employ that appeal to fear in discussing securities with clients or prospective clients?

A As I can best recall, I did, yes, sir.

Q Did you recall any other examples of appeal to fear?

A Yes, sir, one other that I can recall, we were instructed on, and one which I remember using, was in citing the statistics about the income of senior citizens, people 65 years and older in the country, and relating the statistics and figures surrounding that by showing to a prospect or customer that a very small percentage of them actually had enough income to sustain a standard of living which they had comparably been accustomed to, prior to retirement.

Q This is appeal to fear that you were taught?

A As I best remember it, yes, sir.

Q And that you employed?

A As I best recall, I did employ it.

Q Any other appeals to fear?

Mr. Webb: Mr. Dickstein, Mr. Examiner, I have no objection to this document to which the witness has been testifying and looking at is entered into evidence as to what was said and what he used, and we could maybe expedite this matter. There are certain things here that apparently Mr. Dickstein is directing the witness' attention to constantly, and I have no object whatsoever if the document is entered into evidence.

Mr. Dickstein: The witness testified that an examination of a document might assist him in recalling

taught to employ, under these various cate-

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geries of appeal, and my only purpose in showing the witness this document is to assist him in refreshing his recollection, if it does do so.

Mr. Webb: I am just saying --

Mr. Dickstein: The purpose of this line of interrogation is quite different.

Hearing Examiner Gross: Proceed.

The Witness: That is the best I can recall, at this time.

By Mr. Dickstein:

Q You don't recall any others?

A At this time, no, sir.

Q And when you say you don't recall any others, that means you don't recall whether you employed any others and you don't recall using any others; is that right?

A At this time, no, sir.

Mr. Dickstein: My next line of interrogation was going to deal with Roseville-Detroit and Mr. Hirsch is not here and he is in court on an assigned criminal case. I understand he will be here this afternoon.

I also am going to have a rather large quantity of documents that I wish to offer into evidence during this afternoon's session. Might I suggest that we recess now, until 1:30, and perhaps, if the reporter can be here

... a guaranteed basis, that is, they would pay so much a year and then if their profits exceeded a certain amount that the rent would be increased, and that the option that they had at that time or the guarantees were apparently adequate to take care of the indebtedness or the loan that was made on the property.

Q Do you recall whether or not Mr. Kibler discussed the prospectus with you of Westfalls?

A I got a prospectus.

Q Do you recall him discussing it or discussing any part of it?

A No specific part. I -- and here again in discussing prospectuses, to the best of my recollection he has indicated that those prospectuses by reason of the, I presume the Securities and Exchange Commission, requires that they not be particularly glowing in their report but that they be to the contrary, to play down the future or well-being of the firm.

Q Do you recall that being mentioned in connection with the Westfalls prospectus?

A I can't recall in particular.

Q When was this mentioned about, Mr. Kibler's description of a prospectus, in what connection?

A As I say, we received several prospectuses. I know that this is one that we tried desperately to read and

By Mr. Webb:

Q At the time of these transactions were you able to distinguish between a principal and agency transaction?

A Well, if I can recollect, principal would be a transaction where it would be for stocks listed on the exchanges, open stocks listed on the board, and agency would be one within the company of Hodgdon & Co.

Q Regarding Westfalls and Richmond Motor Lodge, what if anything did Mr. Kibler tell you about the marketability of these investments?

A As I can recollect, that they would be easily marketable.

Q You next purchased 263 shares of Transcontinental Class A stock in September '63, for a little more than \$2,000, Dr. Johnson, do you recall that?

A How many shares did you say?

Q 263.

A That's correct.

Q What did Mr. Kibler tell you about Transcontinental investing, to the best you can remember?

A To the best I can remember about that, he said he had made a very careful study of the company and its principal -- I guess president of the company, the name slips me at the moment, Lipscomb -- it has a very well qualified man, a very intelligent, very capable in making investments, and

I have followed them. If they have been reduced --

Hearing Examiner Gross: Did you ever make any independent calculation whether your investment, pursuant to Mr. Kibler's recommendations were within the bounds of this ratio system?

The Witness: No, I have not independently, but I have discussed them with Mr. Kibler.

By Mr. Shapiro:

Q You have discussed them with Mr. Kibler?

A Yes.

Q Did he tell you that your investments were within the ratio system set up?

A To the best of my knowledge he indicated they were.

Q Let me make it absolutely clear. Have you, from time to time reviewed your overall investment situation with Mr. Kibler with your wife being present?

A Yes.

Q Do you have the Richmond Motor Lodge prospectus with you by any chance?

A I may have. (Handing document to Mr. Shapiro.)

Q Dr., I believe you testified concerning Richmond Motor Lodge, that Mr. Kibler told you that the shares in Richmond Motor Lodge were readily marketable. Was that your testimony?

A I think it was not limited to Richmond Motor Lodge.

Q You mean by that that this was true with regard to all real estate shares?

A Yes.

Q You also testified, did you not, that you had read all the prospectuses with regard to the real estate share offerings, is that correct?

A Read, yes.

Q Do you recall reading --

A I can answer that no.

Residing Examiner Cross: Let's wait for the question, Dr. Johnson.

By Mr. Shapiro:

Q Let's see if you can recall this: "There is no present market for the partnership interests being offered; and in view of the limited number of partnership interests being offered and the restrictions on assignment of such interests they may be relatively non-marketable in the future."

Do you recall seeing that on the Richmond Motor Lodge prospectus.

A No.

Q Dr., isn't it a fact that Mr. Kibler told you that while it might be possible for the shares to be marketed, that they did not have the same marketability as ordinary shares of common stock?

A No, I can't recall that as being a fact.

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Q Well, is it possible that he did tell you that?

Mr. Webb: I am going to object to these questions of possible. The Division will concede anything is possible. If the Witness can recall --

Hearing Examiner Gross: Does your answer mean you recall that he did not say it or you can't recall whether or not he said it?

The Witness: I can't recall whether or not he said it.

Mr. Shapiro: That satisfies me.

By Mr. Shapiro:

Q I take it you can't recall whether or not he said substantially the same thing with regard to any of the real estate limited partnership interests that you purchased?

A Would you state the question again, please?

(Question read.)

By Mr. Shapiro:

Q The other limited real estate limited partnerships?

A What you are asking me then, is do I recall whether or not he said anything about any of them or not?

Hearing Examiner Gross: We are talking about marketability.

The Witness: It was my understanding they, or others, the Richard of the others would be marketable; specifically, no I can't.

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our clients would want to put 20 percent or some figure around there of their money into that type of activity with the majority of the money in high-grade securities and real estate.

Q Higher-grade securities being mutual funds?

A Yes.

Q Was there any percentage that was used as a touchstone?

A Roughly, we thought half the money should be in mutual funds investment company shares.

Q What about the other half?

A Well, perhaps 20 percent in special situations, speculations and 30 percent in real estate.)

Q Well, would you say that you were responsible for introducing the ~~financial concept~~, financial planning concept, with the Hedgdon firm?

A Yes, I think so.

Q And, from time to time, you published various bulletins in this connection; did you not?

A Yes.

Q I will show you Division's Exhibit 291 which is already in evidence, and Division's Exhibit 143 which are brochures regarding financial planning.

A Is there a question now?

Q The question is: Who authored these particular

documents, Mr. Hodgdon?

A I did.

Q And --

Hearing Examiner Gross: What are those numbers, please?

Mr. Webb: 291 and 143.

Hearing Examiner Gross: Thank you.

By Mr. Webb:

Q Did you author the other brochures that you published, from time to time, along the theme of financial planning?

Mr. Dickstein: Objection. To what other documents are you referring?

Hearing Examiner Gross: Were there other brochures, other than Exhibits 291 and 143, that you just ~~said~~, which were issued by Hodgdon & Company along the lines of financial planning?

The Witness: (There may have been.)

Hearing Examiner Gross: Would you have authored them?

The Witness: I may have.

By Mr. Webb:

Q (During the time that you were chief executive officer of the Hodgdon firm, did you review the order tickets on a daily basis?)

A I think the first Canadian program was in 1961.

Q Could you tell us how these units are sold, whether they are sold on a principal or agency basis?

Mr. Dickstein: Sold by whom?

By Mr. Webb:

Q By the Hodgdon firm.

A Well, ~~He~~ ~~really~~ acted as an agent for Apache in a sense.

Q And as agent what rate of commission does the Hodgdon firm receive in selling, say, a unit of the Apache oil and gas program of 1961 when it was \$5,000; what would the Hodgdon firm receive in the way of commissions?

Mr. Dickstein: I am going to object to this line of questions. I thought the questions pertaining to Aberdeen were intended to be preliminary to something else, but since --

Hearing Examiner Cross: He is on Apache.

Mr. Dickstein: I understand that. I am explaining why at this point I come in with an objection.

The Division has stipulated that there is no contention in this case that the firm got anything but a reasonable markup. Now, since selling commissions are shown in the prospectus on the Apache oil and gas program -- and I would add in the Aberdeen Fund as well -- I see no purpose to this line of interrogation which is now being put to Mr. Hodgdon.

Mr. Dickstein: I'm prepared to go ahead with a limited cross-examination at this point.

Hearing Examiner Cross: I should think so, because to the extent that there is new matter, to the extent that the admissions present new matter, this can be withheld. I don't see any reason why, to the extent of the present examination as it occurred today, you should not go forward.

Mr. Dickstein: Do I understand that, except for this, Mr. Webb has concluded his direct testimony?

Mr. Webb: Well, I have also here, and I just realized, the statement -- statements, questions and answers taken during the interview of Mr. Hodgdon on May 13, 1964, by the New York Stock Exchange, during which time a reporter was present and took down apparently the verbatim statement of that proceeding. And I would also like to proffer pertinent portions of this transcript which I have before me.

And, unfortunately, there are no numbered lines for the pages, but I will refer to the pages and to the bracketed-indexed items.

Hearing Examiner Cross: Mr. Webb, I'd like to ask you a question.

In going through this have you attempted to eliminate any material with respect to which the witness has already testified and which is merely duplication in these submissions?

Mr. Webb: Yes, sir, I did it rather hurriedly while

I was looking through my notes.

Mr. Dickstein: Has Mr. Webb also eliminated material which he contends to be impeaching? Because if he has not, he is obligated under the rules to point out the nature of the impeachment and to point out the conflict.

Hearing Examiner Gross: Well, now, I want to point out that, if it is accepted over the objection, it would be accepted only as admissions against interest.

Mr. Webb: That's right.

Hearing Examiner Gross: That is the only purpose for this sort of thing.

Mr. Webb: Yes, sir, that is my understanding. And it is not being offered to impeach.

Hearing Examiner Gross: Very well.

Mr. Webb: And I'd like to point out, with respect to the prior testimony, that the witness, Mr. Edgdon, had counsel at that time on 17 and 18 August 1965; was advised of the nature of the investigation, and was also informed of his rights against self-incrimination.

Mr. Dickstein: I think Mr. Webb is referring to -- I don't know what he is referring to, so I won't characterize it.

I would like to say, since Mr. Hirsch is not here, that I am quite certain he will join in my objection, and perhaps have additional objections.

1 By Mr. Webb:

2 Q Did you utilize these specialists?

3 A No.

4 Q Would you tell us why not?

5 A Well I never really was fortunate enough to have
6 any clients that warranted using the specialists. I never
7 came across that type of clientele.

8 Q What do you mean by not having that type of
9 clientele?

10 A Ones with substantial enough money or portfolios
11 that I would have to consult with them about.

12 Q Were there any other reasons?

13 A Well, later on, after I had been there a while,
14 I just got the feeling that they were not quite specialists,
15 that's all, so I didn't use them.

16 Mr. Dickstein: Objection. Move to strike the
17 portion beginning with "I got the feeling that...."

18 Hearing Examiner Gross: Overruled.

19 By Mr. Webb:

20 Q During your employment with the Hodgdon firm,
21 did the Hodgdon firm recommend securities to the registered
22 representatives from time to time?

23 A Yes.

24 Q Will you explain how this was done?

25 A Usually it was done at our Tuesday morning meetings.

1 Mutual funds were recommended, and then various common
2 stocks and various real estate syndications.

3 Q Well how was this brought to your attention? In
4 what form? Documents, oral statements, or what?

5 A Both.

6 Mr. Webb: Would you mark this as the next
7 numbered Division Exhibit, please?

8 (Whereupon the document referred to
9 was marked Division Exhibit 458 for
10 identification.)

11 Hearing Examiner Gross: Off the record.

12 (Discussion off the record.)

13 Hearing Examiner Gross: On the record.

14 By Mr. Webb:

15 Q Mr. Flynn, I will show you a three-page memorandum
16 from the Hodgdon firm dated September 21st, 1962, and it
17 has been marked for identification purposes as Division
18 Exhibit 458, and I will ask you whether you can identify
19 this document?

20 (Handing document to the witness.)

21 A This was the type of documents we used to get
22 quite frequently.

23 Q During the Tuesday morning meetings?

24 A Yes.

25 Mr. Webb: I will offer that into evidence.

1 Mr. Dickstein: No objection.

2 Hearing Examiner Gross: Received.

3 (Whereupon Division Exhibit 458,
4 marked for identification, was
5 received in evidence.)

6 By Mr. Webb:

7 Q What about the chalk board in the trading room?

8 Hearing Examiner Gross: What about what?

9 By Mr. Webb:

10 Q What about the chalk board in the trading room?

11 Did that also indicate what securities were being offered
12 by the firm?

13 A Yes. It listed the securities.

14 Q Would you tell us what you recall the chalk
15 board disclosing on any given day?

16 A It would just tell the number of shares and the
17 issue and the price.

18 Q And what about the commission?

19 A Commission was never printed up there.

20 Q Not on the chalk board?

21 A Not to my recollection.

22 Q You mentioned the various kinds of securities
23 that were recommended during these weekly meetings. You
24 mentioned mutual funds. Which mutual funds were recommended?

25 A Primarily Aberdeen and ICA and Putnam.

18 1 Q You mentioned real estate securities. Would
2 you indicate -- can you tell us what kind of real estate
3 securities?

4 A Limited partnerships and common stock in real
5 estate securities.

6 Q Were these firm underwritings?

7 A Secondaries and firm underwritings, yes.

8 Q What about apart from real estate securities,
9 did the firm recommend common stocks from time to time?

10 A Occasionally common stocks.

11 Q What kind of common stocks?

12 A Occasionally listed securities; and the other
13 common stocks would be speculations or new companies.

14 Q Do you recall whether or not the firm had had
15 these securities in inventory?

16 A Yes, most of them were in inventory.

17 Q Can you tell us what volume of business you did
18 in listed securities during the time that you were employed
19 by the Hodgdon firm?

20 A I did very little.

21 Q Were you present during any of the sales meetings
22 regarding the Van-Pak offering?

23 A Yes.

24 Q Do you recall who spoke during these meetings?

25 A To the best of my recollection, Mr. Luttrell and

1 an inventory in Primex?

2 A Yes, there was a time when they maintained an
3 inventory.

4 Q And you learned that through the weekly sheets
5 that were handed out?

6 A Either that or the board in the trading department.

7 Q Did the board in the trading department show the
8 inventory in a particular security, or simply the bid and
9 asked in securities in which the firm was making a market?

10 A It showed the bid and asked, and it showed the
11 number of shares.

12 Q Did it show the number of shares that were available
13 at those bid and asked prices, or did it show the in-firm
14 inventory?

15 A Oh, no, it never showed the firm's inventory.

16 Q It would simply show the number of shares that
17 were being quoted at that particular offering price, or the
18 number of shares that the firm was willing to purchase at
19 that particular bid price?

20 A That's right.

21 Q And would that be changed during the course of a
22 day?

23 A It would be changed during the course of an hour
24 or a minute.

25 Q And this did pertain to securities in which the

1 firm was making a market?

2 A Yes.

3 Q Did the firm sometimes have securities in
4 inventory in which they did not make a market?

5 A Yes.

6 Q When you received these weekly memoranda,
7 occasional memoranda, listing various securities that were
8 available for sale, did you have any way of knowing whether
9 the number of shares listed in the last column was the
10 number of shares that the firm had in inventory?

11 A No.

12 Q As a matter of fact, did you have any way to
13 know whether the firm was long in these shares, as distinguished
14 from short?

15 A No.

16 Q These were simply the number of shares that the
17 firm would be willing to sell at that particular price?

18 A That's right.

19 Q And that's the way you understood it?

20 A Yes.

21 Q Did the firm from time to time recommend listed
22 securities to its representatives?

23 A Occasionally, yes.

24 Q Did Mr. Hodgdon occasionally discuss listed
25 securities with representatives?

household goods between points within the United States.)

Q Just what is a freight forwarder, Mr. Barrett?

A (A freight forwarder is identified by the Commission as a carrier, although it operates no operating equipment. It purchases transportation such as air, water, rail; it purchases all regulated transportation in its operations.)

Q Would you generally state the nature of your duties as president of Van-Pak?

A I act as general manager, administrator, do general sales work in case of government agencies, national accounts.)

Q By that, do you mean you direct and supervise sales work in relation with government agencies?

A (I direct some, and I carry some on myself.)

Q Did there come a time when Hodgdon & Company underwrote a public offering of Van-Pak common stock?

A Yes, it did.

Q When did this underwriting take place?

A The underwriting was between, sometime in February and April, middle of April in 1952,) completion.

Q (Prior to or during the underwriting period, were there any contracts between the Defense Department and Van-Pak for the movement of household goods of servicemen?)

A Not contracts as such, no.

MR. TIMMONY: Miss Reporter, I ask you to mark this document Division's next numbered exhibit for identification.

(The document referred to
was marked Division's (Ex-
hibit 460) for identification)

BY MR. TIMMELNY:

Q Mr. Barrett, I show you a document marked Division's Exhibit 460 for identification, which purports to be a prospectus registered with the Commission at the time of the Van-Pak underwriting.

I ask you to look at pages 9 and 10 with regard to the company's government business. Directing your attention to these pages, would you read these pages to yourself, please.

A Yes, sir.

Q Mr. Barrett, as of the time this prospectus was written, did it fully delineate the nature of Van-Pak's dealings with the Defense Department?

A Disclose it, you mean?

Q Disclose it.

A Yes.

Q (Prior to or during the underwriting period, were there any contracts between Van-Pak and the State Department for the movement of household goods of State Department employees?)

A No, sir.

Q Prior to or during the underwriting period, were there contracts between ~~Van-Pak and~~ any government agency for the

movement of household goods of any government employees?

A Not contracts as such.

Q Prior to or during the underwriting period, was there a guarantee of income as a result of approvals of Van-Pak's tender of service by the Defense Department?

A No, sir.

Q Again, prior to or during the underwriting period, did Van-Pak have any guarantee of any sort from the government which would produce income?

A No, sir.

Q Mr. Barrett, did you at any time tell any representative of Hodgdon & Company, a principal or otherwise, that Van-Pak had government contracts of any kind?

A I don't recall of any, no.

Q Did you at any time tell any representative of Hodgdon & Company that Van-Pak anticipated government contracts of any kind?

A No, sir.

Q Have you ever attended a sales meeting at Hodgdon & Company?

A I believe I attended two.

Q Approximately when did you attend these sales meetings, Mr. Barrett?

A Some time, I believe, in the latter part of March, during the underwriting, I attended ~~a sales meeting~~, an early.

P R O C E E D I N G S

1
2 HEARING EXAMINER GROSS: All right, go ahead, Mr.
3 Webb.

4 MR. WEBB: As I understand, the purpose of this
5 session is to put into evidence a number of documents which
6 the Division has previously shown Mr. Dickstein, and which can
7 be put in without any foundation, and in this connection I have
8 a number of such documents and would like to have them marked
9 at this time.

10 HEARING EXAMINER GROSS: Off the record.

11 (Discussion off the record.)

12 HEARING EXAMINER GROSS: Mr. Webb.

13 MR. WEBB: I would like to have this next exhibit
14 marked as Division Exhibit 550: it is a compilation of
15 Hodgdon and Company, Inc., memoranda beginning with March 8,
16 1962, to December 10, 1962. Within this group there are 21
17 such memoranda.

18 And is it stipulated these were given to the
19 register representatives from time to time during the period
20 of the documents?

21 MR. DICKSTEIN: We will so stipulate. We do not
22 know, of course, if this is a complete set of memoranda
23 distributed during the period referred to in 1962; but to the
24 extent the Division has submitted these memoranda, we will
25 stipulate they were distributed to the representatives of

Hodgdon and Company about the time indicated.

HEARING EXAMINER GROSS: Is it your intention to indicate later whether there were other memoranda?

MR. DICKSTEIN: I am not sure. We have not ascertained there were other memoranda.

HEARING EXAMINER GROSS: All right. Mr. Webb, let me suggest you read them into the record, the dates.

MR. WEBB: All right. The first memorandum is dated March 8, 1962. There was another memorandum also dated March 8, 1962. The first one is entitled Dart Drug Corporation, and the second one is in connection with Kert Washington, Inc.

The next one is a memorandum dated March 9, 1962. And these will all be for 1962: March 14, March 31, April 9, another one for April 9. The second one deals with the Federal Bar Building; and the first April 9 memorandum deals with Dart Drug, among other securities.

The next one is April 6, May 11, October 1, October 5, October 15, October 22, October 30, November 6, November 13, November 20, November 27. December 4, December 10, and another one for December 10.

That is the end of these exhibits.

HEARING EXAMINER GROSS: Marked and received.

(The documents referred to were marked for identification as Division Exhibit 550 and admitted into evidence.)

MR. WEBB: The next exhibit is a compilation of

Hodgdon memoranda given to representatives, and this compilation relates to a period from January 8, 1963, to December 13, 1963, and contain the following additional memoranda:

January 22, 1963, January 29, February 5, February 12, February 19, March 5, March 12, and on page 2 what looks like March 23, 1963, April 2, April 23, and page 2 of April 23, 1963, May 7, May 14, June 4, June 25, July 1, July 23, July 30, August 7, September 10, September 17, September 30, October 8, November 13, November 19, December 6, and December 13, as previously mentioned; offered in evidence as Exhibit 551.

HEARING EXAMINER GROSS: How many are there?

MR. WEBB: 28.

HEARING EXAMINER GROSS: Received as Exhibit 551.

(The memoranda referred to was marked for identification as Division Exhibit 551 and admitted into evidence.)

MR. DICKSTEIN: We will enter the same stipulation as to Exhibit 551 as we did for Exhibit 550.

MR. WEBB: The next is simply a list of Hodgdon memoranda, and this one compilation beginning with January 7, 1964, and it is page 3 of that memorandum.

The next is January 7 -- I am sorry, I will withdraw the first one since I have the complete one here. January 7, the first full memorandum of January 7, 1964; the next is January 11, January 21, January 22, February 7, February 26, March 5,

1 March 23, April 10, May 22, June 16 -- I withdraw the June 16,
2 1964, document which does not appear to be an internal memo of
3 Hodgdon firm.

4 July 30, 1964, and another document entitled Memorandum
5 1964, Real Estate Information, and this is the last document in
6 1964.

7 Would you like the number of these?

8 HEARING EXAMINER GROSS: What is the last date?

9 MR. WEBB: Well, the last date --

10 HEARING EXAMINER GROSS: All right, I have that, July.

11 MR. WEBB: This is being offered as Exhibit 552.

12 MR. DICKSTEIN: No objection.

13 (The memorandum referred to was
14 marked for identification as
15 Division Exhibit 552 and admitted
16 into evidence.)

17 HEARING EXAMINER GROSS: Admitted, yes.

18 MR. DICKSTEIN: Mr. Webb has just handed me the
19 corporate records and minutes of Hodgdon and Company, from what
20 appears to be the inception of the corporation to a meeting
21 dated November 15, 1962, and the first volume, and then a second
22 volume covering meetings and corporate action from January 8,
23 1963, to and including April 5, 1965.

24 MR. WEBB: We would like to offer up to the meeting of
25 June 30, 1964.

26 MR. DICKSTEIN: Even with that restriction there
27 seems to be no purpose to the offer of all of the corporate

1 By Mr. Webb:

2 Q You previously testified, Mr. Hodgdon, that
3 capital gains should have no influence over an investment
4 decision to sell a particular security, especially in a
5 stagnant company, or a stagnant industry.

6 Do you recall that, sir?

7 A Yes.

8 Q Would you define what a stagnant company is?

9 A That is always a matter of investment opinion.

10 Hearing Examiner Gross: Well, in your opinion.

11 The Witness: In my opinion it is a company
12 that -- a company or an industry where the general earnings
13 of the industry or the company have flattened out over a
14 period of time and have--

15 By Mr. Webb:

16 Q You are going to have to explain what "flattened
17 out" means.

18 A Where the momentum of growth per year, the
19 percentage gain in earnings per year has leveled down,
20 and where there appears to be a considerable technological
21 or scientific threat to the company's principal products: a
22 number of factors that go into it.

23 Q During the time you were president, Mr. Hodgdon,
24 did the Hodgdon brokerage firm have a research department
25 as such?

1 A No, we did not, as such.

2 Q Well who at the Hodgdon firm determined what
3 company was stagnant, or what industry was stagnant?

4 A Nobody made that determination except the men
5 for themselves.

6 Q The individual salesman?

7 A Yes. They had access to the Value Line Survey
8 which gave vital statistics on all the major corporations
9 for the last fifteen years.

10 Q Who was responsible during your presidency for
11 selecting underwritings and securities to be sold out of
12 inventory?

13 A That is two questions, I believe.

14 Q Well,--

15 A I was responsible for -- primarily for the
16 selection of underwritings. And in the case of the sale
17 of securities from inventory, the answer is a little longer.

18 The trading department would try to inventory to
19 some extent those securities which the man were actively
20 to their clients, or in which the men were interested, and
21 to the extent that, occasionally, in trying to keep abreast
22 of the representatives' sales to their clients, the firm
23 would become long to a greater extent than was desirable,
24 or short to a greater extent than was desirable in a certain
25 security. In which case, in the case that we were longer

1 than we wished to be, we would give the registered repre-
2 sentatives a small fraction larger commission on the sale
3 of that security, so that we would change their position
4 from being, let's say, one in which they would have an
5 equal choice among the four securities that they were
6 currently selling or liking, so that they would put a little
7 bit more emphasis on one or another of those securities from
8 week to week. But the list remained approximately the same
9 over many, many weeks.

10 Q Well, Mr. Hodgdon, the question, I don't think
11 you answered it fully; and that is: Who made the decision
12 to take a particular security into inventory at the outset?

13 A This to a great extent was the decision of the
14 trading department, or the man in charge of the trading
15 department, who might consult with me from time to time.
16 But he would try to gauge the interest that the men showed in
17 any particular security. And the only reason we inventoried--
18 and I have hardly any memory of our inventorying in order
19 to make a stock market profit. The reason we inventoried
20 was to try to keep abreast of the demand of our men for a
21 certain stock that was traded over the counter, and also
22 sometimes to take advantage of time when other firms would
23 offer a stock, a block of stock that we could take down
24 advantageously.

25 Q You previously testified, Mr. Hodgdon, that there

1 conversations that were received by Mr. Freed in our office
2 which substantiated my opinion that the company was still doing
3 all right, and that projections for the year were still intact.

4 Q That was favorable information that you received?

5 A Yes.

6 Q On October 23, 1961 Captain Stay purchased 200
7 additional shares of Wise Homes at 5 and three-quarters, is that
8 correct?

9 A Yes.

10 Q Who recommended that purchase?

11 A I recommended that purchase.

12 Q What did you tell Captain Stay at that time?

13 A I told him that it appeared -- that for tax purposes
14 the company still appeared to have things under control, that
15 it was a good time to average down into it, and 31 days later
16 take tax deduction on the original higher cost stock.

17 Q You told him basically it was still a good company,
18 isn't that correct?

19 A Yes, I told him what the problems were on over expan-
20 sion, but that the company indicated that it had things under
21 control.

22 Q And he should average into this stock?

23 A Yes.

24 Q On November 22, 1961 an additional 265 shares of Wise
25 Homes was purchased by Captain Stay at \$4.25, is that correct?

1 A Yes.

2 Q Who recommended that purchase?

3 A I would have recommended to him. Captain Stay
4 could have called me and said "if things are still in order
5 why don't we buy some more?" We have done this on one or two
6 occasions.

7 Q Answer the question, please.

8 A I basically would have recommended it.

9 Q You basically would have recommended it?

10 A Yes.

11 Q That is your best recollection?

12 A Yes.

13 Q What did you tell Captain Stay at that time?

14 A I don't recall specifically.

15 Q What do you recall?

16 A I recall that it would have been approximately the
17 same information that we had several weeks previous.

18 Q Did you inform Captain Stay that you had heard from
19 Mr. Freed or a brokerage firm from North Carolina that the
20 financial condition of the company was poor at that time?

21 A I remember that there were discussions with the
22 management of Wise Homes, that several brokerage firms from
23 Wall Street and North Carolina had been in touch with the
24 company, that the company felt it had things under control,
25 that they had a problem as far as over expansion and lack of

1 production with a lot of small offices that they had set up.
2 But it still appeared to be basically worth while at that time.

3 Q And you are sure of that?

4 A That's what I recall.

5 Q Mr. Adam, on November 22, 1962 you recommended that
6 Dr. Goodwin sell 100 shares of Wise Homes, the same day that
7 you put Captain Stay into 265 shares, and you previously
8 testified that when you told Dr. Goodwin to sell those shares
9 that you had received adverse information from Mr. Freed and/or
10 a brokerage firm from North Carolina. Do you recall that
11 testimony?

12 A Yes, I do.

13 Q And was that testimony truthful?

14 A I would say basically it was truthful, yes.

15 Q And the testimony that you just gave with respect
16 to the Captain Stay transaction, that was untruthful?

17 A No, I know that there were tax considerations involved
18 in the purchase and sale of Wise Homes for Dr. Goodwin as
19 well as Captain Stay.

20 Q Did you inform Captain Stay that you were getting
21 certain of your customers out of Wise Homes at the time that
22 you were recommending that he get into Wise Homes?

23 A I don't recall that.

24 Q Will you explain what a cross trade is, Mr. Adam?

25 A Cross trade is where you buy for one client and

7 1 A Yes.

2 Hearing Examiner Gross: Mr. Adam, the question does
3 that serve to refresh your recollection means something very
4 specific, and it means not did you look at a piece of paper
5 and see that date and assume that that is the date, but the
6 question means that do you now remember that that was the
7 date. Now do you remember that that was the date or are you
8 accepting the date because it says so on that schedule?

9 The Witness: Well, I am really doing that, going by
10 the schedule; and to the best of my ability I recall that that
11 would be the settlement date.

12 By Mr. Webb:

13 Q Trade date was the 16th of November, 1961?

14 A Yes.

15 Q And settlement date November 22, 1961?

16 A Yes.

17 Q What did you say to Dr. Goodwin when you recommended
18 that she sell 100 shares of Wise Homes at that time?

19 A I don't recall what I said to her. I know that I
20 would have told her that we would have--

21 Q It's not what you would have told her -- it's what you
22 told her.

23 A I don't recall. I don't recall what I would have
24 said.

25 Q You testified on direct examination that one of

1 the reasons that you recommended that she sell 100 shares of
2 Wise Homes at that time was because of information you had at
3 the time. Now what was that information?

4 A I recall that around that time we had received --
5 Hodgdon and Company had received word through either Mr. Ireed
6 or a report from a brokerage firm in North Carolina regarding
7 the company's financial condition, and it appeared that at
8 that time for tax purposes as well as cutting short our loss
9 in it that we should take, that I suggested to Dr. Goodwin
10 that we sell the Wise Homes.

11 Q What was the report or the information that you heard
12 from Mr. Freed or from the report from North Carolina regard-
13 ing the financial condition of Wise Homes at or about that
14 time when you recommended that Dr. Goodwin sell these shares
15 of Wise Homes?

16 A I recall that Mr. Freed had been in direct contact with
17 his source of information in North Carolina, and I probably
18 would have--

19 Hearing Examiner Gross: Mr. Adam, probably means
20 you guess. Now we want to know whether you now recall--

21 The Witness: I don't now recall.

22 Hearing Examiner Gross: --the reasons why you told
23 Dr. Goodwin to sell those shares.

24 The Witness: I don't recall at this time.

25 By Mr. Webb:

1 Q Was this financial information adverse at that time?

2 A I would think so.

3 Q Is that your best recollection?

4 A My best recollection is that it would have been some--

5 Q Adverse news?

6 A Adverse news.

7 Q So then getting back to this 100 shares transaction,
8 the sale by Dr. Goodwin of 100 shares of Wise Homes, there
9 were two reasons now. One was for tax purposes, and number two
10 because of adverse information that you learned?

11 A Yes.

12 Q Dr. Goodwin sold 200 shares of Wise next. That was
13 in December of '61, is that correct?

14 A Yes.

15 Q What was the basis of that recommendation?

16 A Basically the same information as the previous recom-
17 mendation.

18 Q Tax purposes and bad news?

19 A Yes.

20 Q Major Finance was a purchase by Dr. Goodwin of 200
21 shares December, 1961, is that correct?

22 A Yes.

23 Q Was this a speculation?

24 A Yes, it was.

25 Q What inquiry did you make into Major Finance before

part of your lecture?

THE WITNESS: I believe that I mentioned that, yes, sir.

HEARING EXAMINER GROSS: Go ahead then. I'm sorry.

THE WITNESS: That I gave them a very brief opinion of it as to the effectiveness of these options and the problems that can arise by the use of them.

And I had felt that perhaps there would be some other way to handle these proceeds, but that this was a matter that should be organized and discussed at the point of death when the need was actually imminent, rather than planned five or ten years in advance.

I believe that my testimony yesterday in essence or basically would cover that same ground.

BY MR. WEBB:

Q Well, did you go into with the salesmen how monies already invested in life insurance policies could be used in better ways such as the investment in mutual funds?

A Under specific circumstances, yes.

Q And what did you tell them in that respect?

A That I did not consider money in life insurance as being an investment, that this was a savings account, a lending transaction, and that I felt that the use of the money outside of the insurance function -- that any monies that would ordinarily go into the "cash values" of a life insurance contract could more

effectively be used in other areas.

I personally felt and said that I felt that if they were put into securities that mutual funds would be the closest approximation of the concept used by the life insurance company except that you get away from the lending transaction into a direct ownership.

Q So you did explain to them though how funds could be generated from the cash surrender value of insurance policies for mutual funds?

A Yes.

Q And also how money could be borrowed on life insurance policies for the investment in mutual funds?

A - Yes.

Q Would you agree then, Mr. Smith, that one of the purposes of teaching the salesmen about insurance was to show them where investors had additional funds in the form of the cash surrender value of life insurance policies or the loan value of policies so they could invest in securities.

A Oh, certainly.

Q Did you ever tell salesmen in the training classes that you previously described that they should be, and I quote, "offhanded in their approach to life insurance with a client"?

A Yes.

Q Would you explain that?

A I felt that the subject of life insurance when discussed

1 that point if they did business with me.

2 Now I think it is essential that you form your
3 own chart so that you judge your success because some days
4 maybe you won't get anyone interested and other days you will
5 get a lot so you will have to go by averages.

6 On days that you are very fortunate, don't get
7 overly optimistic. The days that you have had tough luck,
8 don't get overly depressed.

9 Now when someone comes in, I would normally cover
10 four points with each one. The first thing, I would give
11 them a general description of what the firm did, the various
12 areas it was in, something like, "We handle stocks on all
13 the Exchanges and over the counter. Over the counter means
14 not listed. On top of that, we handle all the bonds. There
15 are some minor exceptions to each one of these things but
16 this is generally what we can handle. We handle practically
17 all the mutual funds. We get into real estate. At times,
18 we get into gas and oil. At times, we help with profit-
19 sharing plans. Also, we give thoughts on trusts and wills."

20 And then I would say, "Be careful that you don't
21 practice law because you don't draw these up. The function
22 here is to get them to their attorney, but the seed you
23 plant might make them make a will."

24 Then my function is to find the objective and see
25 what they have to work with and give them thoughts on how to

1 Q The fourth paragraph down, towards the middle
2 of the paragraph:

3 "Just think of the money we both could
4 have made if you had listened to me on General
5 Motors, RCA, GE, et cetera, instead of me listen-
6 ing to you."

7 What did you tell Mr. Rosen about General Motors,
8 RCA, GE, et cetera?

9 A For the record, that's the --

10 MR. DICKSTEIN: Excuse me. I have no objection
11 to the last portion of that question if that's the question.

12 HEARING EXAMINER GROSS: Were you reading when
13 you said, "What did you tell --"

14 MR. WEBB: The question is: What did you tell
15 Mr. Rosen about General Motors, RCA, GE, et cetera.

16 MR. DICKSTEIN: I have no objection to the
17 witness answering the question, what did you tell Mr. Rosen
18 about General Motors, GE, RCA; I do have an objection to
19 a portion of the question which involves the selection from
20 the Rosen letter of Rosen's comment on the subject.

21 HEARING EXAMINER GROSS: Well, no matter how you
22 view it, there is only one question: What did you tell.

23 Now apparently the witness is asked to look at
24 this portion of the letter and then to answer the question:
25 What did you tell Mr. Rosen?

1 I'll take it.

2 THE WITNESS: I told him various things about
3 these stocks at various times during the time he was in
4 the States and, for the most part, summarizing what I told
5 him, I told him that if he bought his funds, his mutual
6 funds, Putnam and Aberdeen, he would in effect have his
7 participation in this type of stock in a much more effi-
8 cient and probably more meaningful way than if he were to
9 buy 5 or 10 or 20 shares of any one of these stocks, or
10 of several of them.

11 That's the best of my recollection of the various
12 discussions we had.

13 His letter of January, '64, was referring to
14 conversations that he and I had had as early as 1960 and
15 '61, and he was evidently bringing to recollection --

16 MR. WEBB: Objection.

17 HEARING EXAMINER GROSS: Sustained.

18 MR. WEBB: I offer into evidence Division Exhibit
19 No. 744.

20 MR. DICKSTEIN: Objection.

21 HEARING EXAMINER GROSS: I would like to see it.

22 (Document handed to the Examiner.)

23 MR. DICKSTEIN: I would like to reframe my objec-
24 tion if I may, since Mr. Webb has now read into the record
25 what appears to have been his only purpose in making any

1 MR. DICKSTEIN: Yes, sir.

2 THE WITNESS: I don't recollect anything on this
3 subject from attending these meetings.

4 BY MR. WEBB:

5 Q You don't have any independent recollection in
6 this area then?

7 A That is correct.

8 Q Before these hearings you've attended?

9 A These hearings?

10 Q These hearings.

11 A Yes. I've attended these hearings.

12 Q Did you yourself sell any Van-Pak stock to Vir-
13 ginia residents?

14 A I became aware of that again at these hearings.

15 Q Can you now recall whether or not you sold Van-
16 Pak common stock to Virginia residents?

17 A Yes.

18 Q Who did you sell that stock to?

19 A A man by the name of Hoeph1 -- I can't recall his
20 first name offhand -- and Wimberly Coerr. C-o-e-r-r.

21 HEARING EXAMINER GROSS: "C" did you say?

22 THE WITNESS: C-o-e-r-r.

23 BY MR. WEBB:

24 Q How were these order tickets and confirmations
25 marked?

1 and so forth.

2 THE WITNESS: All right, sir.

3 Gentlemen, you must organize your thoughts very
4 clearly and very concisely to make an adequate presentation.

5 Now in any presentation, when you want people
6 to take a certain action, you have to go through certain
7 steps, whether you are a doctor trying to get the patient
8 to consent to a needed operation, whether you are in the
9 field of religion and you are trying to get the people on
10 your side, whether you are selling some other intangible
11 like securities. How do you do that?

12 Once again, whether you are the doctor, whether
13 you are a member of the clergy, or whether you are in our
14 business, there are five basic ingredients to a presentation
15 getting people to accept your ideas.

16 What are they?

17 Gentlemen, I'm going to give you just an outline
18 of a presentation and when I am finished, I would like for
19 you to then this evening, tomorrow, and the week ahead,
20 put together your own sample presentation, using my outline
21 and you will come back and we will have each of you give
22 a sample presentation to other members of the class here.
23 And after you are finished, we will all critique it, and
24 tell you what is good about it, and what is bad.

25 And now to the five steps.

1 And I go to the blackboard and I write:

2 Step 1, Introduction.

3 The client wants to know, as soon as you meet
4 him, who you are, who do you represent, and what products
5 do you have that he could use. You point out that Hodgdon
6 and Company offers financial planning service to prospec-
7 tive investors and I would suggest you use a large yellow
8 pad to draw a diagram of our services. Put down the
9 initials "FP" in large letters, financial planning, and
10 then describe the products around the circle around the
11 letters, "FP" and indicate the products that we have avail-
12 able in our firm.

13 For example, Mr. Jones, at Hodgdon and Company
14 we try to do a total job of financial planning for our
15 clients. We know that many people buy securities hit or
16 miss, and have a collection of securities with no specific
17 goal in mind. We suggest that we organize a financial
18 plan, if possible, geared to your economic circumstances.

19 At Hodgdon and Company we handle not only stocks,
20 bonds and mutual funds, but also real estate syndications.

21 At this point, gentlemen, you might stop and
22 tell them that in the local area, we have underwritten
23 several large properties in the area. You might describe
24 one of them such as the Federal Bar Building. A lot of
25 people know that, and then go on and explain that, in . . .

1 addition to the real estate, for people in the high tax
2 brackets, we have oil and natural gas programs, and that
3 if that person is in a 50 percent program, he might enjoy
4 hearing more about that; that we are interested in, if
5 possible, saving him some tax dollars; that we would like
6 to find out, from looking at his circumstances, whether
7 there is a need for him to see his attorney regarding a
8 will and whether he should consider the use of trusts.

9 Explain very quickly, gentlemen, that we are
10 not experts in all these areas. We don't have all the
11 answers, but we think we know where to find them. Because
12 there is one weakness that I have found among stockbrokers
13 in my past -- depending on the then period, 10 or 15 or
14 whatever it was -- and that is that when people ask you
15 a question about securities, about investments, about facts,
16 you can't possibly know all the answers, and be quick to
17 admit that.

18 But tell them that we have access to people that
19 we feel are experts in the various fields that you mention,
20 and that you will attempt to find the answers.

21 Now, gentlemen, that introduction shouldn't take
22 more than about five minutes of your initial presentation.

23 Point 2 is that no matter how good your presen-
24 tation, unless you can stir people out of their lethargy,
25 you can give them all the information in the world, but

1 unless you show them a need to act, they are not going
2 to do anything.

3 So you must appeal to them not only on a fact
4 basis but you also must appeal to emotion. You must get
5 them to react to the facts. And how is that? Well, hope
6 of gain. Point 2, hope of gain.

7 MR. WEBB: What was point 1, sir?

8 THE WITNESS: Introduction.

9 Gentlemen, everybody goes to work in the morning.
10 They work every day of the year, 2000 hours, and what are
11 they doing with their money? Well, they are trying to get
12 ahead. They are trying to accomplish something. They
13 would like to gain. They would like to gain an education
14 for their children. They would like to gain a measure
15 of independent wealth for retirement. They would like to
16 gain enough money so that they could travel extensively.
17 In other words, they have a basic need to acquire.

18 We know if you show the man that if he had
19 begun investing as little as \$25 a month over any 10,
20 15, or 20-year period since 1892, and that would be the
21 history of our stock market, the Dow-Jones, you would
22 find he would have a very handsome result.

23 We know further that if you will explain to
24 them, if they can just save the first 10 percent of their
25 money for themselves and then spend the rest, that they

1 have a chance at independence. So give the man this hope
2 of gain. Appeal to the basic sense-- I guess, for want
3 of a better word, you can call it greed. And in paren-
4 thesis, we put that word.

5 I use that word, "greed," gentlemen, for its
6 shock value. I want you to remember that it is very impor-
7 tant to appeal to the hope of gain.

8 Step 3, fear of loss.

9 I mentioned a moment ago that people wanted to
10 acquire certain things. They want a certain sense of inde-
11 pendence. Well, what are the facts?

12 Most people don't realize -- and I dare say,
13 gentlemen, that most of you in the room today don't know
14 that in the richest country in the world, one man in 500
15 ever acquires a net worth of \$25,000 or more.

16 Did you also know -- and let me show to you and
17 read to you from the Connecticut State Medical Journal,
18 50 percent of all the doctors who died in the last ten
19 years in the State of Connecticut, and this would probably
20 hold true in other states as well -- died bankrupt.

21 Did you know that 85 percent of our people
22 reaching the age of 65 are living on less than \$200 per
23 month?

24 Did you know that 54 men out of every 100 are
25 living on friends, relatives and charity?

1 These are shocking statistics, aren't they?

2 Well, what happened? What happened to the
3 richest country in the world? Why are people dying broke?

4 Well, Mr. Jones, it is probably because they
5 haven't ever established a strategy for handling their
6 money, something that we call financial planning. And we
7 suggest that you establish a balanced financial approach
8 to your money as follows:

9 Now, gentlemen, use the yellow pad again. Draw
10 a line down the center, a line across the top, forming a
11 "T", and on the left side, write the word "fixed dollars,"
12 and on the right side, write the word, "flexible dollars."

13 Point out to Mr. Jones, the prospective client,
14 that most people have their money in -- and write down on
15 the left side -- insurance, government bonds, savings and
16 loan, credit unions, that their income comes from these
17 sources as well as their government retirement benefits,
18 their company pension plans, et cetera.

19 Now what kind of dollars are those? Those are
20 fixed dollars, dollars that were destroyed and will be
21 destroyed by inflation, or which will be very, very useful
22 in the event of a depression or deflation.

23 Point out to Mr. Jones-- Let's assume that he
24 is working for the Department of the Interior, age 46, the
25 average age of the average investor, and let's assume that

1 he has a \$12,000 a year income. Assume his basic high
2 five average earnings at \$12,000 a year--

3 MR. WEBB: May I ask what "high five" means?

4 MR. DICKSTEIN: I think the witness just said--

5 HEARING EXAMINER GROSS: The witness just
6 said the five highest years of a man's earnings.

7 Is that accurate?

8 THE WITNESS: Yes.

9 HEARING EXAMINER GROSS: And I think the witness
10 is referring to Government jobs, Government employees.

11 Is that correct?

12 THE WITNESS: Yes, sir.

13 HEARING EXAMINER GROSS: All right, go ahead.

14 THE WITNESS: I meant, gentlemen, that the man
15 is at the Department of the Interior earning about \$12,000
16 a year. The formula that you will learn and use later on
17 in our advanced training session are how to compute the
18 civil service benegits, but for now, use a rule of thumb
19 that if a man has worked for 30 years for the Government,
20 he can plan on approximately 50 percent of his average of
21 the highest five years of income while he worked for the
22 Government.

23 So, Mr. Jones, in this example I am showing you,
24 let's assume that you have \$12,000 a year income now.
25 Upon retirement then, you will be receiving about \$6,000

1 per year on the fixed-dollar side from Government retire-
2 ment benefits. Is that correct?

3 Mr. Jones will either agree with you or not.

4 Now, Mr. Jones, our idea is this. You should
5 not have all of your assets and your income coming in from
6 just one side of this balanced "T". You should have it
7 equally divided. There should be-- If you are going to
8 have \$6,000 a year coming in from fixed dollars, then you
9 should have \$6,000 coming in from flexible dollars, so
10 that you might maintain your standard of living that you
11 enjoyed prior to retirement after retirement.

12 Now what kind of items are on the fixed -- excuse
13 me, on the flexible dollar side, Mr. Jones?

14 Well, stocks can go down as well as up; there-
15 fore, they are flexible. Real estate, mineral wealth
16 such as oil and natural gas, your own business, all these
17 things are flexible.
18
19
20
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25

1 Now, Mr. Jones, you can see what we have here.
2 If we in this country have another 1929, where securities
3 values and equity values, the flexible dollar side were
4 harmed, and harmed greatly, then you will be able to get
5 by on the fixed dollar income. If, on the other hand, as
6 seems much more likely, we have continued inflation, then
7 shouldn't you place some of your assets on the flexible
8 dollar side?

9 Mr. Jones, let me stop for a moment. This word
10 "inflation," everybody uses the word "inflation." Everybody
11 talks about it. We see it every day in the paper. We know
12 that it is always going up two-tenths of one percent or
13 one-tenth of one percent, and nobody really pays any
14 attention to it. But they always pay very close attention,
15 and there is a lot of talk at cocktail parties about how
16 the stock market -- and I am afraid a lot of people do it --
17 the stock market is an air-conditioned indoor racetrack,
18 when actually the facts are if you have a balanced approach
19 in your planning and an economic stronghold is being built,
20 it cannot tear you down under any circumstances.

21 Now, I mention this word "inflation." This is one
22 of the few countries that has not had, at least as yet,
23 runaway inflation. I would like to take a look, Mr. Jones,
24 at what happened in Germany in 1923. Let's assume that you
25 had \$65,000 in fixed dollars guaranteed German marks or

1 bank stocks -- excuse me, bank assets in Germany in the
2 year 1923. A very fine civilized country at that time.
3 A short time later the \$65,000 cash bought two good meals.
4 That is inflation.

5 But if, on the other hand, you had put \$30,000
6 or \$32,500 in fixed assets and put the other \$32,500 in
7 Volkswagen and I. G. Farben and so on, what would have
8 happened? You would have been perfectly protected on the
9 income side during a rampant inflation in Germany.

10 We can go on and find inflation trends throughout
11 the world, going back. And I think the British even
12 measured the pound sterling against a bushel of wheat.
13 It is even going back to the ancient Egyptians, some comment
14 on how many bushels of wheat it took in exchange for an
15 ounce or something. How many more bushels it took at one
16 period than another. So inflation is something that is
17 here to stay. We are not going to get rid of it. And it
18 is something I feel you must protect against.

19 Do you agree?

20 Now, gentlemen, any point in your presentation
21 with a prospective client, if he does not agree with the
22 general concepts then don't go on. Stop and let him talk.
23 Find out what it is he does not agree with. Are these
24 basic concepts something that do not appeal to him? Maybe
25 he doesn't want to save any money. If they don't appeal to

1 him, then fine, don't push the issue. There are two million
2 people in the vicinity and you are not to force yourself on
3 anyone. I don't think you will have to. Nine out of ten
4 people are anxious to hear about sound financial planning.

5 Now, gentlemen, this third point that I mentioned,
6 fear of loss. Just remember the word "fear." That is the
7 key word, the shock word, and I want you to have this
8 presentation, this outline memorized. I want you to be
9 able to help people when it comes to establishing a balanced
10 concept, and you must do it by these various appeals that
11 we have talked about today.

12 The fourth point is goal.

13 HEARING EXAMINER GROSS: The fourth point is what?

14 THE WITNESS: A goal, setting a goal.

15 Mr. Jones, we suggest that before we begin
16 investing, if you care to, that we establish where we are
17 going, what we are shooting for. Well, in your example
18 here at the Department of the Interior you are earning
19 \$12,000 a year. I suggest that we should have \$6,000
20 coming in per year after your retirement from the flexible
21 dollar side. Now, if an investment program generated 6
22 percent to you, how much money would we have to have upon
23 your retirement some twenty years from now to produce this
24 \$6,000 per year? Well, that's right, \$100,000.

25 Can we achieve that? I don't know. We would

1 like to try.

2 But, before I go on I would like to ask you some
3 questions about yourself, Mr. Jones. I have here a data
4 sheet. It is a confidential data sheet that will help me
5 with our financial planning work.

6 And at that point, gentlemen, you go through the
7 data sheet, you acquire and collect as much information as
8 you can about the man. If it is anything but a simple, very
9 simple case, if the man has a list of securities, if he has
10 got a good deal of real estate and so on, anything but a
11 simple case, you bring it back to the firm, tell the
12 prospective investor that you are bringing it back to the
13 firm to go over it with senior members of the firm, and that
14 you will draft recommendations with them and you will also
15 arrange for your next appointment with the prospective
16 investor at which time you will present the completed
17 recommendations:

18 Mr. Jones, you ask him his age, his dependents
19 and their ages, the amount of insurance, the premiums, his
20 salary, his savings, his home, mortgages, everything on the
21 data sheet as completely as you can get it.

22 Well, Mr. Jones, I want to thank you for giving
23 me this information. And I might go back and tell you for a
24 moment now how do we handle or suggest that the flexible
25 dollar side, the equity side of this balanced "T" be handled.

1 Well, we suggest that -- and you use the yellow
2 pad again, gentlemen, a long line across the page.

3 Mr. Jones, all investments can be thought about on
4 a scale of risk, a continuum. At the right end of the
5 scale, very high-quality low-risk; at the left end, very
6 high-risk speculative end of the scale.

7 Now, Mr. Jones, we call this the ratio system of
8 investment, and we believe that you should put a minimum of
9 50 percent of your investable funds, that is the flexible
10 dollar side funds, in the hands of professional investment
11 managers, either directly through investment counselors or
12 indirectly through mutual funds.

13 We believe that you should have 30 to 40 percent
14 of your money in individual securities and real estate.
15 In this area we should agree, you and I, Mr. Jones, ahead
16 of time on what we feel are the best industries and then
17 stick to securities in those industries. And I mentioned
18 to you prior to this about the type of real estate that we
19 handle in this area.

20 And then we suggest that no more than 10 to 20
21 percent for gambling.

22 Now, we can have just as much fun, Mr. Jones,
23 losing 10 to 20 percent of the money as we can all of it.
24 But what I want to assure ourselves of today is that with
25 80 to 90 percent in high quality investments, that we shoot

1 for the attainment of the goal that we establish. In other
2 words, I want to end up with the investment cake, and there
3 may or may not be speculative frosting on the cake, but we
4 don't want to end up without any cake.

5 How does that sound to you, Mr. Jones? Does it
6 sound like the ideas that I have presented today are worth-
7 while, something that you would like to pursue?

8 Now, gentlemen, if he has given you the information
9 on the data sheet and you come back and sit down with that
10 data sheet and with a yellow pad and draft out what you
11 think you would do for that prospective client, after you
12 have done that, and not before, then bring it to me and we
13 will go over it, and remember, I reserve the right, along
14 with my officers, to amend or override any considerations
15 that you may have -- any recommendations that you may have
16 made on that rough draft. And that will go on for a period
17 of approximately one year, until you have demonstrated that
18 you can develop financial planning cases on your own.

19 I would like for you to keep in mind one thing
20 further, and that is that you can make all kinds of these
21 presentations, and don't be awfully disappointed if not very
22 many of them become full-fledged financial plans. People
23 are very funny about their money. They know what they should
24 do, but they very seldom do it. So you finally end up in
25 your account books, you will end up with three types of

1 people, you will end up with accounts, you will end up with
2 customers, and you will end up with clients. Three categories.

3 Clients, gentlemen, are people who know what
4 financial planning are about and who have adopted it.

5 Customers are people who know what it is about and may or
6 may not have adopted it partially. And accounts, they buy
7 and sell stocks on an occasional, traditional non-approach
8 basis.

9 Thank you.

10 BY MR. DICKSTEIN:

11 Q Mr. Haight, from time to time, at Tuesday morning
12 meetings, did you give brief lectures on sales approaches
13 and sales presentations?

14 A Yes.

15 Q In these brief approaches, did you refer to any
16 of the material that you have just given us, the lecture
17 content that you have just given us in your sales presentation?

18 A Yes.

19 Q Did you, from time to time, at Tuesday morning
20 meetings, reiterate the, I believe, four or five main
21 phases of sales presentation?

22 A Yes.

23 Q What was your purpose in doing that at Tuesday
24 morning meetings?

25 A Well, you find that when you teach any concept it

Q And during the relevant time, were individuals terminated because they did not meet their quota system as set forth in the exhibit which is Respondent's 13-B?

A In part, yes.

Q Do you recall how many such individuals were terminated?

A It must have led to the termination or the resignation of two or three people.

Q Is that all?

A It may have been more.

I don't recall now -- probably more.

Q More than five?

A I'm trying to fix the period -- up to July 1, 1964. I assume that's the period?

Q Yes, sir.

A I think at least five.

I am not sure of that.

Q In Paragraph 3 it says that one of the prerequisites of the individual was that he must earn net commissions to himself of \$600 per month from investment sales of high quality.

How much would a salesman have to sell in gross volume in order to earn \$600 a month?

Can you give us an idea?

A Yes. About \$30,000 worth of --

1 Q Individual securities?

2 A Individual securities, mutual funds or real estate.

3 Q That was the minimum. Is that correct? According
4 to this 13-B Respondent's Exhibit?

5 A Yes. That would be either the face amount or the
6 contractual plans as you see above or the individual securi-
7 ties as you see below.

8 Q So that I will understand this document more
9 clearly -- in other words any combination of mutual funds
10 sales or individual stock sales or syndications which would
11 be the face amount of \$30,000 a month, that would be adequate
12 in order to meet the \$600 net commission to the salesman?

13 A It would depend on the commission rate on whatever
14 it was that was sold, but it would be some combination of all
15 of those things, excluding speculations and gambling stocks.

16 Q All right.

17 During the relevant period of 1960 to 1964, who had
18 the ultimate responsibility for reviewing financial plans
19 prepared by the salesmen?

20 A Myself and the other officers of the firm.

21 Q The other officers being Mr. Carr and Mr. Hodgdon?

22 A Mr. Richardson.

23 Q Occasionally Mr. Freed?

24 A Occasionally Mr. Freed.

25 Q When Messrs. Freed, Adam, Kitain and Harper joined

cb10

As I understand the witness' testimony, Hodgdon and Company can't receive a commission on a transaction which is an issue which is listed on the New York Stock Exchange and not listed on the Philadelphia-Baltimore Exchange. As a result, when this occurs, it is placed through--

What's the firm's name?

THE WITNESS: Mr. Dackerman.

HEARING EXAMINER GROSS: -- Dackerman and, as a result, in other transactions, Dackerman gives up to Hodgdon and Company in order to -- the equivalent -- I don't know whether necessarily it is the equivalent, but the practice is well-known and I don't think you need to burden the record with it.

MR. DICKSTEIN: Very well, sir.

BY MR. DICKSTEIN:

Q Mr. Haight, is the give-up in an equivalent number of dollars?

A Virtually.

Q During cross-examination you testified that the firm received reciprocal business from mutual funds which it sold. That is correct, is it not?

A Yes.

Q Does the firm of Hodgdon and Company and did the firm of Hodgdon and Company during the relevant period of

eb11

1 time (receive^d reciprocal business from all mutual funds that
2 it sold?)

3 A Yes.

4 Q (It was and is the practice in the industry for
5 mutual funds to give reciprocal business to such brokerage
6 firms as sell their mutual funds,) is it not?

7 MR. WEBB: Objection.

8 THE WITNESS: Yes, it is. Excuse me; I'm sorry.

9 HEARING EXAMINER GROSS: What's the basis?

10 MR. WEBB: The basis is, I don't think what the
11 practice in the industry is-- I think the relevant part is
12 what these Respondents did, and I'm going to object to any
13 reference to what the industry does.

14 HEARING EXAMINER GROSS: Read the question back,
15 please.

16 (Whereupon, the Reporter read from the record
17 as requested.)

18 MR. DICKSTEIN: I would like to say that this is
19 a preliminary question to another. I am not interested in
20 exploring industry practice per se.

21 HEARING EXAMINER GROSS: Also, if I remember
22 correctly, this was a matter of extensive discussion in the
23 special study, wasn't it?

24 THE WITNESS: Yes, sir.

25 HEARING EXAMINER GROSS: I will allow it.

FINANCIAL PLANNING WORKSHEET

214

Div Ex-16

Arthur H. Rosen

DATE OF BIRTH 10/27/22 AGE 37

5522 Warwick Pl., Chevy Chase 15, Md

TELEPHONE OL 4-8032

POSITION US Foreign Service Officer

POSITION

HOME ADDRESS Dept. of State

TELEPHONE DU 3-4494

DEPENDENTS:

Name	Relationship	Date of Birth	Life Insurance
Jeanne Rosen	Wife	8/22/29	
Ed L. Rosen	son	1/22/53	
W. M. Rosen	son	10/21/54	
Robert K. Rosen	son	4/21/58	

FINANCIAL OBJECTIVES:

Retirement:

Monthly Income Needed \$

Social Security

Pension

Other

Sub-Total

Needed from investment sources.

Total monthly income necessary for proper retirement.

Other:

\$ Total other funds needed.

COMMENT:

Total Capital Required: \$

INSURANCE:

Date Purchased	Amount	Type	Annual Premium	Company	Insurance Status
9/10/40	2000	20 pay life	51.00	Metropolitan	
10/27/48	5000	"	173.80	NY Life	
10/27/51	10,000	"	370.40	"	
10/27/52	5,000	"	188.25	"	
12/45	10,000	"	\$240. (approx)	Nat. Service (GI)	
8/1/57	15,000	term (double indem)	\$104	For. Serv. Protective Assn.	
	10,000	Term	\$45	Government Insurance	

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Description	Cost 214 a	Mortgage	Yrs. Remaining	Present Value
House A lot	\$29500	\$14760	15	31,000
	\$	\$		(air conditioned since purchased)
	\$	\$		
	\$	\$		

Gross Income per year from Real Estate \$
Net income per year from Real Estate \$
Tax status of Real Estate Cash flow \$

WINGS:

INCOME:

\$ 500 Cash and/or Bank \$ 10,000 Salary
* 300 Gov't. Bonds (children's)
2000 Savings & Loan
2000 Other (children's accts.)
\$4500 Total \$ Total

\$ Savings per month none now - expect
% Tax Bracket save part on expected
of \$1200 a year expected
during 1950

VESTMENTS: (Use separate sheet if necessary)

No. of Shares	Name of Company	Date	Cost		Present Value		
			Per Sh.	Total	Per Sh.	Total	
50	GM	1/3/58	337 1/2	16875	531 1/8	2660	Owned by David
50	Am. Cyanamid	various	30 (ave)	1500	60	3000	John
30	Monsanto	1/15/59	40 3/8	1230	54 1/8	1620	David
100	Am. Serv. Life	12/59	3.50	350	3.50	350	Robert
	Abandonment Equity	12/1/59		4031.57			David

SCELIANEOUS:

Have you made a Will? yes. Is there a possible inheritance? yes
In the event of premature death, what amount of money per month would your wife or other dependents need? \$
Do you contemplate substantial charitable contributions? \$ 300
Have you considered the use of Trusts in your Financial Planning? no

DITIONAL DATA:

My wife and children are ~~benefit~~ contingent beneficiaries of trust fund established by her late father. Income goes to her mother during mother's lifetime. Rough estimate of present value of her share of that fund is \$50,000. My wife would also share in 50% of any estate left by her mother.

EXHIBIT # 52
VAN-PAK PROSPECTUS

THE COMPANY

Van-Pak, Inc. (the "Company") is a non-regulated freight forwarder engaged in forwarding household goods door-to-door by the "containerization" method, primarily to and from overseas military installations. The Company also leases metal containers to industry.

The containerization method of transportation involves packing the household goods in a rigid container at the point of origin and then thru-shipping the container by rail, motor, sea and/or air common carrier to the point of final destination without rehandling the household goods at common carrier interchange or interline points. Reusable containers are constructed of reinforced steel and aluminum. Disposable plywood and fiberboard containers are also used in this method of transportation.

INTRODUCTORY STATEMENT

As indicated by the Statement of Income and Expense, the Company (since its organization in August 1959) has sustained net losses of \$192,801.88 for the fourteen month period ended September 1960 and \$194,936.60 for the fiscal year ended September 30, 1961. The Company has realized \$18,436.40 (unaudited) net income for the three months ended December 31, 1961, which is not necessarily indicative of the results of operations for the year ending September 30, 1962.

The price of the stock being offered bears no relation to net assets or earnings. Net losses amounted to \$387,741.48 (audited) at September 30, 1961 and \$369,305.08 (unaudited) at December 31, 1961. Total liabilities as of December 31, 1961 in the amount of \$323,886.29 exceeded total assets by \$101,184.08. The proceeds of this offering will be used, in part, to eliminate such insolvency, and the Company has urgent need of such funds. If the Company is not successful in expanding its business, it may result in further insolvency. Accordingly, an investor should take into consideration his ability to sustain total loss of his investment. The proceeds of this offering will provide funds for only a limited amount of expansion.

The Company is engaged in the containerized method of transportation which is currently gaining in acceptance with carriers, industry and the shipping public. Although the idea of containerization is not new in the transportation industry, it has not received a wide application until the last three to five years. The Company did not originate the containerized transportation method. The Company has, however, spent considerable time and money in developing containerization in the field it is presently primarily engaged in, the forwarding of household goods. Mr. Charles H. Barrett, the Company's president, has been engaged in experimental and development work in the containerization field since 1952. It is likely that others will enter the industry using this mode of transportation. In addition, the Company is in direct competition with the many van-line movers, large and small, operating throughout the country and overseas. Many of these competitors have larger financial resources than the Company.

The Company is firmly convinced that containerization is the coming mode of transportation, not only for household goods but also for general commodities. The Company intends to enter the field of containerized transportation of general commodities by leasing re-usable metal containers for this purpose. There can be no assurance or representation, however,

ministrative office; Chicago, its sales and dispatch office; Kansas City, its accounting and billing departments; and has part-time sales representatives in Washington, D. C., and Los Angeles. The Company intends to move its administrative office to Washington, D.C. At the present time the Company has three clerical employees and three administrative officers.

The dispatch and control of the containers is directed from the Chicago office by Mr. Stephen H. Pollack, Executive Vice-President. He also solicits domestic and foreign sales. Mr. Charles H. Barrett, President, performs general administrative work, directs and supervises sales, contacts government agencies and directs agency relations.

Non-Regulated Freight Forwarder

The Company is operating as a non-regulated forwarder of used household goods under an exemption contained in Section 402(b) (2), Part IV, of the Interstate Commerce Act. Under this exemption, which has been part of the Act since 1942, a freight forwarder of used household goods is not subject to regulation if it engages only in the forwarding of used household goods. The Company is not regulated by state regulatory commissions.

Government Business

At the date of this Prospectus substantially all of the Company's business is with the Government. In December 1961 the Company's tender of service was approved by the Military Traffic Management Agency (MTMA) for use by the Army, Navy, Air Force and Marine Corps in door-to-door container mode of service at approximately 580 installations within the Continental United States and between the U. S. and approximately 125 installations in 12 overseas countries. The Company has also filed its tariff at approximately 40 installations in 17 overseas countries where MTMA approval is not required. Prior to December 1961 the Company's tender was approved in approximately 22 installations. The Company has appointed Agents to serve its business at all installations where its tender is filed.

The MTMA approval authorizes the Company to submit door-to-door Container Service and Rate Tenders to all military installations of the above military services in the areas indicated and it is qualified in all installations to which tenders have been submitted. A Department of Defense Regulation has been issued which establishes provisions to guide the transportation officers in determining if an applicant is qualified. It also covers the selection of carriers and distribution of orders. The Regulation provides that only those carriers will be used which provide high quality service at lowest overall cost to the Government. If more than one carrier has submitted the same low rate, the Regulation states that the traffic shall be distributed among such carriers in equitable proportions. In competing for the lowest tariff rate the Company must compete against the Military Sea Transport Service, an instrumentality of the United States Government.

Tariff Structure

As noted, the Company is not regulated. Its tariffs are not passed upon or reviewed by any licensing or other Governmental agency. When the Company decides to submit a service tender to a military installation, it reviews the common carrier fees for loaded container freight charges, makes service and fee arrangements with origin and destination agents, and then determines what rate it must charge to permit it to make a gross profit on a shipment. Then the Company files that tariff rate with the transportation officer. If the Company's

SECURITIES AND EXCHANGE COMMISSION

DOCKET NO.

Commission's EXHIBIT No. 73

Respondent's Page 1 of 3

IN THE MATTER OF: GoodwinDATE: 8-24-66WITNESS: Goodwin

August 26, 1960

ACE-FEDERAL REPORTERS INC.

By: W. B. B.

(Name of reporter)

PREPARED FOR:

Dr. Georgina Y. Goodwin
6704 Mammalia Drive
Baltimore 12, Maryland

FINANCIAL SUMMARY:CURRENT STATUS:

Age: 35 years Occupation: Physician-Anesthetist
Annual Income: \$15,000 Oct. 21, 1965
Dependent: Mrs. Helen T. Goodwin - Mother (age 7)
Tax Bracket:

SAVINGS:

Cash and/or Bank	\$7,000
Insurance Annuity Pd in full	40,000
Total	\$47,000

(Savings per month = \$300 - \$400)

INSURANCE:

Lincoln National Life (Health & Accident)	\$117.00
Marc Casualty (Health & Accident)	252.63
Lincoln National Life (Major Medical)	50.00
Blue Cross-Blue Shield Hospital & Medical	57.40
Malpractice Insurance (\$500,000)	210.23
Total Premiums	\$597.13

REAL ESTATE:

	Cost	Mortgage	Present Va
Residence:	\$27,500	\$16,000 @ 7 1/2%	\$29,000
Mortgage years remaining		- 21 years	

INVESTMENTS:

<u>No. Shares</u>	<u>Company</u>	<u>yr.</u>	<u>Present Value</u>	
350 1/8 1/32	American Smelting	1951	@56	\$19,600
30	American Smelting 1/8 1/32	1952	@144	4,320
60 1/8 1/32	American Telephone	1952	@93	5,580
1	Pot Luck Investment Club	1959	@24.96	524.16
			Total value of inv.	<u>\$30,024.16</u>
(net worth = \$39,000)				

FINANCIAL GOALS:

The establishment of a Planned Investment Program which will receive continuous professional management and supervision and which would provide the necessary funds from investment sources for retirement plus the possibility of the disability of Mrs. Goodwin in the near future.

Total capital required is \$150,000 at retirement at 6% = \$9000/yr or \$750.00 per/month.

In addition, such an Investment Program should offer safety, opportunity for profit, protection against inflation, and a freedom from the worry and detail of most other ways of investment.

RATIOS:

It is suggested that the Investment Program be formed using the following ratios:

- 60% Placed under the supervision of Professional Investment Managers by acquiring shares in at least two regulated Investment Companies, i. e., Aberdeen Fund and Putnam Growth Fund. (60% = \$45,000)
- 30% Held in individual securities and real estate - all having outstanding quality characteristics. (30% = \$22,500)
- 10% Used for special situations and/or intelligent speculation. This figure not to be exceeded, as capital once lost is difficult to regain under today's confiscatory tax rates. (10% = \$7,500)

Using the above ratios will give the program the necessary "balance" and keep any emotions from affecting prudent investment decisions.

RECOMMENDATIONS: (see page 3)

Dr. Goodwin

RECOMMENDATIONS:

1. To implement the Investment Program it is recommended that the following action be taken:
 - (a) Request the cash surrender value of the \$40,000 annuity that you wish to invest.
 - (b) Sell 150 shares of American Smelting = \$3,400.
and 50 shares of American Smelting
2. From the above transaction:
 - (a) Acquire two units (\$5,000) in \$3,000,000 apt. development.
 - (b) Place \$20,000 in Aberdeen Fund
 - (c) Place \$15,000 in Putnam Growth Fund
 - (d) Hold \$10,000 for real estate syndications in near future.
 - File -->* (e) Invest \$100/mo in Aberdeen Fund.
 - File -->* (f) Invest \$100/mo. in Putnam Growth
3. Hold all remaining securities in portfolio.
4. Maintain adequate Emergency Fund (min. \$3,000).
5. Evaluate Insurance Program.
6. Investigate the use of trusts in your Will to avoid estate tax burdens in the future. *Quarter 1954*
7. Set aside \$500 for capital gains tax.
8. Formal annual review of overall financial position with your Investment advisor checking progress towards the accomplishment of investment objectives.

COMMENT:

My objective, Dr. Goodwin, is your investment success both now and in the future. I'm certain you will find that the type of "balanced" Investment Program recommended will be outstanding in every respect.

SECURITIES AND EXCHANGE COMMISSION

DOCKET NO.

Commission's EXHIBIT No. 79

Report's Page 1 of 2

IN THE MATTER OF:

DATE: 6-24-66 WITNESS: Repdun

ACE-FEDERAL REPORTERS, INC.

By: [Signature] (name of reporter)

January 24, 1953

Miss Georgina Y. Goodwin, M.D.
6704 Maralee Drive
Baltimore 12, Maryland

FINANCIAL SUMMARY:

Investments	Shares	Cost	Value	Est. Income/yr.
Aberdeen	8202	\$15,695	\$17,470	
Putnam	2237	15,618	18,522	
Total		\$31,313	\$35,992	
Cheverly Terrace	1	\$2,700	\$2,700	270
Falls Plaza	3	3,000	3,000	240
Rock Creek	2	5,000	5,000	400
Toledo Plaza	1	2,500	2,500	250
West Falls Plaza	5	5,000	5,000	450
Total		\$18,200	\$18,200	\$1,610
Jonker Business Machine	250	\$2,500	\$ 5500	
Lord of Flice	6	3,000	3,000	
Major Finance	206	800	437	
Metro Securities	300	900	525	
Orbit Industries	700	2,645	1,155	
Precision Inst.	50	650	700	
Vahlsing, Inc.	100	750	425	
Van-Pak, Inc.	100	500	110	
		\$11,745.	\$6,032. (\$4,893)	
Cash credited to account		321.74	321.74	
Overall Totals		\$61,579.74	\$61,265.74	

RECOMMENDATIONS:

1. Will must be current and up-to-date.
2. Insurance analysis must be made periodically too.
3. Better record keeping must be established due to new tax regulations. (In process)

Miss Goodwin

-2-

4. During the worst market decline since 1940, we did well. As you can see most of the funds were concentrated in top-quality, professionally-managed companies with proportionately less risk involved. Quality, tax-sheltered real estate also aided us during the "1962 Crash."

Your systematic method of investing in Aberdeen and Putnam must be maintained at all costs. These should be the first two checks written each month.

Speculation, as you can see, has not paid off to-date but the percentage invested in this area is limited. It takes 2 - 4 years for this type of investment to work out. The risks are great but so are the rewards!

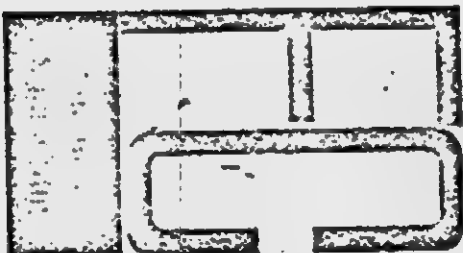
COMMENTS:

Georgina, you must be congratulated on the overall performance to date; and, as we continue to work together over the years, we are planning to double the amount of invested capital.

Sincerely,

David M. Adam, Jr.
Assistant Vice President

DMA:ps



To improve on this, give some consideration to our offer to get together with us and share some of our experience in this field. Many of us at Hodgdon & Co. have gained our experience the hard way and we feel we can make the path to financial security easier for you.

What It Is

FINANCIAL COUNSELING could be described as getting people to plan financially in order to make the most of their money or assets.

By financial planning we mean that your savings pattern should be directed in the light of your tax bracket, pension and social security benefits, retirement plans, dependents, insurance set-up, any special goals or dreams you may have, then these factors have to be correlated with modern money management methods taking into consideration the likely increase in the cost of living, taking advantage of tax deferrals and possibly trust arrangements and a host of other tools.

We at Hodgdon & Co. feel that much of our work is pioneering in a field in which there is much need but little practice outside of the families of great wealth (strange that where money is needed the least you find decisions made on a rational basis—and generally the reverse among the economically less fortunate).

We believe that we can help anyone and everyone get better results, but first we must overcome a great deal of tradition and prejudice, myth and legend, not only in our own fraternity but in competitive ones as well.

Through the application of insight into money matters, better financial results can usually be obtained just as insight in any field usually pays off. Financial insight implies looking through the fears and half-truths which hinder the strategy of most people.

Every era obsolesces yesterday's strategy and rules-of-thumb. Only a few rules stand the test of time: quality, diversification, intelligent management—still, the first and last are relative terms. In a holocaust diversification may be inferior to centralization of assets. Only clear thinking in specific instances will obtain the best results.

Proper strategy and clear thinking for the problems of today are not easily come by. We find very few people who understand what life insurance is all about. We find very few people who hold our opinions on investing in stocks, real estate, and oil.

Not that our opinions are necessarily correct. But they are not stale ideas. And they tend to conform to the attitudes of practicing experts in the field rather than to the viewpoints held by wholesale merchants of securities and life insurance. We find that most people of wealth have different ideas about the making and management of money than the people

who do not have much money. We find it much easier to talk to the people of wealth, but much more necessary to talk to the people of moderate means.

What It Can Do for You

Financial Counseling can help the man of means protect his position and grow wealthier, and can give the man of moderate means a blueprint to improve his position.

Financial Counseling can help the "Have-Not" become "Haves".

How?

Well, it takes lots of talking and a little doing.

The talking is necessary in order to convert the "Have-Not" to thinking like the "Haves".

The "Haves" hold wealth in the form of stocks, real estate, and oil. The "Have-Not" hold wealth in the form of insurance savings, Government Bonds, and deposits in lending institutions. When the "Have-Not" go into stocks they usually buy cheap issues or those quality stocks which are over popular and too high. When they buy real estate it is usually marginal property or second trust notes. And when they buy or drill for oil may the Lord help them.

In the period 1929-30 some of the "Haves" adopted the investment policy of the "Have-Not" and got out of equities and into fixed-dollar investments. But not for long. The flow back to equities in 1931 accelerated after we went off the gold standard. Today you do not find important private money in fixed dollar investments excepting tax-exempt bonds as an offset to predominantly equity holdings.

The greatest problem in our every day counseling is to get people out of savings and into equities. We feel that every dollar which seeks savings instead of tangibles is a dollar working in the wrong direction.

We believe, as do the wealthy, that in the long run there is less risk in equities than in savings. And of course, the chance for vastly greater appreciation. But the man in savings is riddled with short-term fears. He is frightened to death of losing his cash equivalents. He will gamble in equities but he will not really commit his funds to equity investment as a strategy.

The psychological barrier for the man in savings accounts lies in his belief that he is safe. He cannot see that the value of his savings is dependent upon the economic system continuing to function pretty much as it has in the past. He loses sight of the fact that the prospect of a cataclysmic economic upset which inhibits his buying of equities would, if it materialized, also imperil his debt paper. If businesses, factories, and real estate lose their value, what are debt obligations against these properties going to be worth? If corporations have not profits and individuals have no incomes, where will the United States Treasury get the money to pay maturing bonds and bond interest? The unsophisticated investor who sticks

Hodgdon & Co., Inc.

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 111 West Gaston, Greensboro, North Carolina • BRoadway 5-6323

- FINANCIAL PLANNING IN SECURITIES
- PROFIT SHARING
- REAL ESTATE SYNDICATIONS
- INSURANCE REVIEWS
- OIL PROGRAMS

PHILADELPHIA • BALTIMORE STOCK EXCHANGE

No. 11

1962

FINANCIAL COUNSELING SECURITIES AND EXCHANGE COMMISSION

FILE NO.

Responsible

IN THE MATTER OF:

DATE: 7-28-66

WITNESS:

ACE FEDERAL REPORTERS, INC.

By

(name of reporter)

ACTION MAKES THE DIFFERENCE

WHAT IT IS

WHAT IT CAN DO FOR YOU

ACTION MAKES THE DIFFERENCE

A huge volume of literature has recently been written on this subject under titles like "Estate Planning", "Money Management", and "Financial Planning".

You could go blind reading reams of this generally helpful advice.

And you will continue to get mediocre results if you don't have a way to implement your new found strategy.

The trouble with this advice is that it is worth absolutely nothing if it is not put to practice. The proper management and strategy of investments, insurance, trusts, wills and the like is not a matter of general agreement, but of far greater significance is the lack of any action at all on the part of most adults. Most adults through inaction get exactly what they deserve: they get their insurance and investments dumped on them by salesmen hungry for commissions.

Why? Why don't business and professional people expend the relatively small effort on decisions which will so importantly affect themselves and their families?

At Hodgdon & Co. we do not have all the answers, to this or to any other question. We, personally, are constantly groping for insights that will help solve our own and our clients' financial problems. We feel that helping people to security is a tremendously constructive and rewarding avocation, in a way similar to the practice of medicine. But like the physician one of our greatest frustrations is our inability to do the complete job, the ultimate diagnosis. In part, like the doctor, this is due to our lack of knowledge and insight, but worse, it is due to enforced passivity in our approach to the public. All of us are concerned with our health and our wealth, yet each of us tends to reject pressure from a doctor or from people offering financial counsel.

Why? Our own personal experience makes us certain of this answer. It is FEAR. A FEAR of facing money and the future. It is a natural fear, like that of going to the dentist or doctor, because money has become so important that a majority of persons need push its real significance into their subconscious minds.

Today, money stands for a tremendous amount in reckoning individual well being. Today's individual cannot fall back on amulets, cattle, wives, land and shrunken heads for his prestige, security, and independence.

Yes, that's what money is: prestige, security, and independence. A good wife helps, but unless you implement her services with a healthy helping of coin of the realm the little lady faces an unworthy future. She will end up pressed into 100% domestic service in the distinguished employ of some husband who let money matters go hang or who fell for the "Guaranteed Retirement" pitch.

To improve on this, give some consideration to our offer to get together with us and share some of our experience in this field. Many of us at Hodgdon & Co. have gained our experience the hard way and we feel we can make the path to financial security easier for you.

WHAT IT IS

FINANCIAL COUNSELING could be described as getting people to plan financially in order to make the most of their money or assets.

By financial planning we mean that your savings pattern should be directed in the light of your tax bracket, pension and social security benefits, retirement plans, dependents, insurance set-up, any special goals or dreams you may have; then these factors have to be correlated with modern money management methods taking into consideration the likely increase in the cost of living, taking advantage of tax deferrals and possibly trust arrangements and a host of other tools.

We at Hodgdon & Co. feel that much of our work is pioneering in a field in which there is much need but little practice outside of the families of great wealth (strange that where money is needed the least you find decisions made on a rational basis — and generally the reverse among the economically less fortunate!).

We believe that we can help anyone and everyone get better results, but first we must overcome a great deal of tradition and prejudice, myth and legend; not only in our own fraternity but in competitive ones as well.

Through the application of insight into money matters, better financial results can usually be obtained, just as insight in any field usually pays off. Financial insight implies looking through the fears and half-truths which hinder the strategy of most people.

Every era obsoletes yesterday's strategy and rules-of-thumb. Only a few rules stand the test of time: quality, diversification, intelligent management — still, the first and last are relative terms. In a holocaust, diversification may be inferior to centralization of assets. Only clear thinking in specific instances will obtain the best results.

Proper strategy and clear thinking for the problems of today are not easily come by. We find very few people who understand what life insurance is all about. We find very few people who hold our opinions on investing in stocks, real estate, and oil.

Not that our opinions are necessarily correct. But they are not stale ideas. And they tend to conform to the attitudes of practicing experts in the field rather than to the viewpoints held by wholesale merchandisers of securities and life insurance. We find that most people of wealth have different ideas about the making and management of money than the people who do not have much money. We find it much easier to talk to the people of wealth, but much more necessary to talk to the people of moderate means.

WHAT IT CAN DO FOR YOU

Financial Counseling can help the man of means protect his position and grow wealthier, and can give the man of moderate means a blueprint to improve his position.

Financial Counseling can help the "Have-Nots" become "Haves".

How?

Well, it takes lots of talking and a little doing.

The talking is necessary in order to convert the "Have-Nots" to thinking like the "Haves".

The "Haves" hold wealth in the form of stocks, real estate, and oil. The "Have-Nots" hold wealth in the form of insurance savings, Government Bonds, and deposits in lending institutions. When the "Have-Nots" go into stocks they usually buy cheap issues or those quality stocks which are over popular and too high. When they buy real estate it is usually marginal property or second trust notes. And when they buy or drill for oil may the Lord help them.

In the period 1929-30 some of the "Haves" adopted the investment policy of the "Have-Nots" and got out of equities and into fixed-dollar investments. But not for long. The flow back to equities in 1931 accelerated after we went off the gold standard. Today you do not find important private money in fixed dollar investments excepting tax-exempt bonds as an offset to predominantly equity holdings.

The greatest problem in our every day counseling is to get people out of savings and into equities. We feel that every dollar which seeks savings instead of tangibles is a dollar working in the wrong direction.

We believe, as do the wealthy, that in the long run there is less risk in equities than in savings. And of course, the chance for vastly greater appreciation. But the man in savings is riddled with short-term fears. He is frightened to death of losing his cash equivalents. He will gamble in equities but he will not really commit his funds to equity investment as a strategy.

The psychological barrier for the man in savings accounts lies in his belief that he is safe. He cannot see that the value of his savings is dependent upon the economic system continuing to function pretty much as it has in the past. He loses sight of the fact that the prospect of a cataclysmic economic upset which inhibits his buying of equities would, if it materialized, also imperil his debt paper. If businesses, factories, and real estate lose their value, what are debt obligations against these properties going to be worth? If corporations have no profits and individuals have no incomes, where will the United States Treasury get the money to pay maturing bonds and bond interest? The unsophisticated investor who sticks his head, ostrich-like, into a vault doesn't know that he might take a real loss of 50% on his money over the years due to inflation. He is much more concerned over losing 10 or 15% in the near term in stocks or realty.

It is just this kind of financial myopia, this excessive preoccupation with the short term, which the financial counselor must overcome by explaining to the client that each and every investment election has an unavoidable risk attached to it. When the client comes to learn that holding cash or bonds is not a way to avoid making a decision nor a way to avoid risk, then he is prepared to consider the various alternatives for his money and arrive at decisions based on reason rather than emotion. Needless to say, this is not possible in the case of many individuals due to their socio-economic background and conditioning.

Financial Counseling can show the individual how to avoid certain risks in equity investment. It can show him the risk he is taking in his savings programs. It can show him how to achieve better results and get more for his money in life and property insurance. It can show him how to avoid unnecessary taxes and how to plan for his family's welfare should he die prematurely.

Perhaps most constructive of all, Financial Counseling can provide a financial blueprint for the future, a plan that affords the client the peace of conscience in knowing that he has done his best with what he has for himself and his family.

This act of planning is outstanding evidence of maturity in the individual, and when completed can change the life and attitude of the client. We have seen many cases which amount to a transformation of personality and character.

We ask — how can anybody have any real peace of mind if he doesn't know where he is going financially, or how he will get there? How life will be 10, 20, 30 years ahead? How much money to meet how many needs?

We do not believe at all that your present standard of living should be sacrificed to the future but we feel very strongly that an intelligent application of your assets for the future can enhance your present peace of mind and enjoyment of life. Financial Counseling at Hodgdon & Co. can assist you in making intelligent decisions in many areas:

Stocks and Bonds

Immediate execution of all stocks traded on national exchanges, over-the-counter stocks, and bonds.

New Issues

In its function as investment banker and underwriter, the firm seeks to raise capital for companies with a high degree of management and exciting features. We are extremely selective and generally never undertake to finance a company in which we are unwilling to make a personal investment.

Advisory Service

Advice on individual stocks is freely given, based on the firm's constant transactions and friendship with leading investment companies and institutional buyers.

The firm retains a well known economist for fortnightly consultation on the broad aspects of the economy.

We believe our financial library — separate for your convenience — to be the finest in this area, particularly in regard to expensive periodicals and service generally unavailable elsewhere.

Mutual Funds

There are a great many funds from which to choose and, as in the case of stocks, some are designed to give the holder steady income or a reasonable guarantee of it; some aim primarily for capital gain and others try to combine the qualities of both gain and income. An evaluation of the various funds takes time and know-how; Hodgdon & Co., an authorized dealer for the leading Funds, is equipped to perform this evaluation and will help you select the Mutual Fund "right" for you.

Insurance

The firm makes no charges and takes no commission on insurance purchases. An associate counselor of the firm may take the ordinary commission involved in a purchase of insurance in the event that the planning is approved by the client.

We feel that our insurance counseling service is the most important opportunity we can offer the average person who has only seen his protection program from the point of view of the life insurance salesman who sold it to him.

Real Estate Syndications

The firm is constantly seeking projects worthy of syndication for our clients. In general we reject properties which are not in top condition and strategically located, and those of less than one million dollars value. To obtain attractive properties, it is frequently necessary to create them. This takes a good deal of time, with the result that there has been a scarcity of offerings. Consequently, in the past, we have restricted each individual client's participation in order to include as many people as possible in each syndication as it materializes.

Oil

Offered only by Prospectus to qualified clients with high tax liability. A diversified drilling program which is not designed for the average investor.

Trusts and Wills

General advice is implemented by specific recommendations as to forms and attorneys. There is presently no charge for consultation and advice at Hodgdon & Co.

Profit Sharing

Through a unique package, we feel we can introduce to eligible companies a profit sharing system which overcomes many problems of the time and cost involved in installation and operation.

HODGDON & Co., Inc.

Members of the Philadelphia-Baltimore Stock Exchange

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JEFFERSON 4-8800

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BETHESDA 14, MARYLAND
OLIVER 4-8960

111 WEST GASTON
GREENSBORO, NORTH CAROLINA
BROADWAY 5-6323

MEMBERS PHILADELPHIA-BALTIMORE STOCK EXCHANGE

February 16, 1961

REPRESENTATIVES' BONUSES ON SALES OF PREFERRED
MUTUAL FUNDS

PURPOSE:

The purpose of this memorandum is to outline the eligibility requirements, methods of computation, eligible funds and other data pertinent to bonuses on sales of Preferred Mutual Funds.

ELIGIBILITY REQUIREMENTS FOR REPRESENTATIVES:

1. Each representative becomes eligible for a bonus when the following requirements are fulfilled:
 - a. Six months of continuous employment have been completed.
 - b. The representative has terminated the use of a drawing account.
 - c. Any deficit in the drawing account has been repaid in full.
2. The effective date of employment is determined from the date of registration approval by the National Association of Securities Dealers. For purposes of administration the effective date shall commence with the first day of the month coincident with or next following the date on which the above requirements are fulfilled.

METHOD OF COMPUTATION:

1. Bonuses are based on volume of sales of Preferred Mutual Funds and are computed semi-annually commencing with the first of January and the first of July. On outright purchases of Mutual Funds the settlement date shall determine the period within which the sale is applicable. In

the case of systematic payments and fully paid contractual plans the receipt of payment by Hodgdon & Co., Inc. is the determining factor for the period in which these payments are calculated.

2. The schedule of bonuses is as follows:

<u>Sales Volume</u>	<u>% Bonus*</u>
\$30,000 - \$49,999	5%
\$50,000 - \$69,999	10%
\$70,000 -	15%

- * The maximum % bonus during the 6 months to one year period of employment is 5% regardless of the volume of sales attained.

3. To arrive at the bonus to be received, the total commissions generated by the volume produced is multiplied by the appropriate percentage.

Example: Let us assume that a representative sold \$90,000 of Preferred Mutual Funds. Normally, this would constitute a total commission of \$5,400. In this instance the representative would receive a bonus of \$810.00 ($5400 \times .15$).

N. B. Letters of Intention, although raising the volume, produce lower commissions. Therefore, two letters of intention of \$50,000 each do not produce as great a bonus as 10 sales of \$10,000 each.

PREFERRED MUTUAL FUNDS:

The following mutual funds constitute those to which the bonus is applicable:

Aberdeen (except monthly contractual plans)

American Mutual Funds

Boston Fund

Canada General Fund

Canadian International Growth Fund

Century Shares Trust Fund

George Putnam Fund

Incorporated Investors
(periodic plans presently
in effect only)

Institutional Funds (all series)

Ex. 147
(cont.)

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International Resources Fund

Investment Company of America

Massachusetts Investors Growth Fund

Massachusetts Investors Trust

Nucleonics Chemistry &
Electronics (except monthly
contractual plans)

Putnam Growth Fund

GROWTH INFORMATION:

Although no changes are intended, your company reserves the right to make such changes as are in the best interests of the firm. At such time as changes are made your firm will notify you, as soon as possible, relative to these changes.

In case of disputes regarding eligibility, amount of bonus, or any other matter relative to bonuses, the matter shall be resolved by the executive committee of your firm.

A. Dana Hodgdon
President

ADH:pak

7
Div Ex 156
id

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SECURITIES AND EXCHANGE COMMISSION

FILE NO. 3-533

156

IN THE MATTER OF:

Hodgson

DATE: 8-1-66

WITNESS:

Doppen

ACE FEDERAL REPORTERS, INC.

By

W. D. Baughman
(name of reporter)

Mr. A. Kemp Poffin
105-A Canal Street
Frederick, Maryland

Wednesday, Aug. 23rd

Dear Jim:

I am sure you realize it was a very
major undertaking for me to turn-over
such a big amount of monies, as I am
now in the process of doing. You assure
me it is prudent; but none-the-less

it frightens me. As you said on
Sunday — "let me be the one
to worry."

It's a must that I play it
safe. I've a feeling that the future
held terrific expenditures for me,

and I just must safeguard all
I have to merit it,

Would not it be a good idea for
me to have a copy of your plan
you worked out for me and presented
me on Sunday? Perhaps if I
studied and re-studied it, I could
have that feeling of security so
essential to me,

Sincerely,

Ann D.

Div EX 157ed
From the Desk of:

JAMES W. HARPER, III

August 25, 1961

Dear Ann,

yes, I appreciate the fact that Sunday's step was a mighty big one for you. I was so worried that you would want to maintain a status quo, giving very little direction to your money. I must stress to you that, when I look at your account, I see nothing but a series of Safety-guards, percentages, actions of conservation; you are playing it safe. I do not

From the Desk of:

JAMES W. HARPER, III

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want you to worry one iota about the future. That you could see the need of acting Sunday assures me now that you understand the need of stopping when stopping is needed. You have every possibility of being a millionaire in ten years or less. If you willing to take risks, I can assure you of \$1,000,000. But risks are what you do not want. We must seek high return, growth and safety. This we are getting. Every step we take, every dollar charged has

From the Desk of:

JAMES W. HARPER, III

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its purpose; it is fitting into a plan. I shall supply you with a copy of the entire fellow and your holdings within a month. We still have several loose ends to check up and then I shall be able to render a summary to you which will carry us along until next March or February. You will have a complete program for your own use.

The thing I wish you would do is stop worrying. Please. You have so much security that it induces a concern.

From the Desk of:

JAMES W. HARPER, III

4.

This is quite natural. A person always fears his losing that which makes him what he is! If this concern becomes too great, then there is a danger that he will lose his "special powers." In other words, you desire to maintain your security and have stopped your taking a step, a needed step. Here you desire for a status quo with a "Don't-rock-the-boat" feeling. I shall have over ruled reason.

You see, I know well your concern. It is mine also! That is why I

From the Desk of:

JAMES W. HARPER, III

5

Just stressed the need to speed
the rearrangement of your portfolios
over a seven year period. I have
now changed it to three years. We
are now $2\frac{1}{2}$ years "ahead" of schedule.
While I wanted to preserve your portfolios'
power, I also wanted to preserve your
feeling of security and comfort. Finally,
for your protection I felt that I had to
risk this feeling for your actual
security. No matter how secure you
felt you are no more comfortable
than that which your money will buy.
You are 50% better off today than

From the Desk of:

JAMES W. HARPER, III

6

You were Sunday. You will see why
in a year or so. Remember, you have
not sold Muck, General Motors
totally! You still own a little in Abudon,
but the risk is spread. G.M. and Muck
could now collapse and you would not
be hurt. Sure Abudon might go
down 2-3¢, but if Muck or G.M. had
collapsed before 10% of your wealth
would have fallen. This is why we sold
100 Reynolds - too much in one place.

I point all of this out to stress to
you that you are under a plan. Months
ago, I was afraid I would scare you

From the Desk of:

JAMES W. HARPER, III

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if I were to reveal it to you.
Remember, my concern is for your
mental attitude as well as your
physical well being. And it is
this that makes this firm different.
If you were on the road to becoming
worth \$1,000,000 and you were working
yourself sick, it would be better to
keep you at \$200,000 and totally
happy. We are now keeping you
comfortable and moving you towards
the \$500,000 - \$750,000 mark.

You shall have a total map of the
plan within a month.

Jim

III. SPECULATIONS

Name	Cost	Value	Currently Projected Income	Yield
"Lord of the Flies"	\$ 500	\$ 700	_____	_____
Return of \$500 plus small distribution should be completed prior to year end. Limited Partnership.				
Farmers Cooperative	93	93	<u>554</u>	<u>6%</u>
#93-9640 - 6/12/59				
Canadian Oil	7,500	7,500+	500	7%

The Canadian Oil Program is still being carried as a speculation until a full evaluation is completed. Bids have run as high as \$25,000 per unit. This may be considered an under evaluation.

<u>\$3,093</u>	<u>\$8,293</u>	<u>\$1,000</u>	<u>15%+</u>
Total	Total	Income	Yield
Cost	Value	<u>1,000.00</u>	

September 18, 1962

Prepared For:

Captain & Mrs. Charles A. Stay
3414 Old Dominion Boulevard
Alexandria, Virginia

Financial Summary:Current Status:

Age: 54 L. E. = 54 + 22 = 76

Captain - U. S. Navy - 19 years service

Base Salary \$10,080.00

Housing & Food Allowance 2,216.00 (non-taxable)

Total Salary \$ 12,296.00

Income from Real Estate 2,235.00 (non-taxable)Total Annual Income \$ 14,531.00

Dependents - Mrs. Stay: L. E. = 55 + 25 = 80

Pension starting approximately July 1963 = \$5,460. Minimum

Real Estate Income (non-taxable) 2,400.Approximate Retirement Income \$7,860.Savings:

Cash and/or Bank \$ 300.00

Monthly Investments 100.00

Total Monthly Savings \$ 400.00 +

1 July 1963 (First Salary)
21 years
53% of age 20.7 years

Ex. #204 (cont.)

<u>Life Insurance</u>	<u>Annual Premium</u>	<u>Amount</u>
Ordinary Life	\$130.26	\$ 5,583.
N. S. L. I.	<u>142.20</u>	<u>10,000.</u>
	\$272.46	\$15,583.
Ordinary Life on Wife	\$ 22.01	\$ 1,000.

Real Estate: (See Attachment)Investments: (See Attachment)

Total Investment Capital	\$ 125,000 minimum
Total Net Worth	120,000 minimum
Total Net Worth for Estate Purposes	135,000 minimum

Financial Goals:

Your overall investment program does offer growth, continuous professional management, diversification, and tax-sheltered income in order to prepare for your retirement from active duty with the U. S. Navy. You must be complimented on your successful accumulation of wealth over the years. This success places you within the top 4% of all individuals in the country!

Because of the proper use of the ratio system with approximately 60% of the value of the securities under professional management, we have lost less during the latest "market crash" than accounts having all monies in stocks. Also, with approximately 20% in real estate, we have increased the income substantially. All of this income is estimated to be 90% tax free and non-reportable during the next several years.

Over the short term, the speculation stocks are doing very poorly. Percentage wise, there is about 10 - 15% of the invested capital based on your cost vs. value involved in speculations. We will have above average results if only 3 out of 7 produce over the next 2 years.

Recommendations:

1. Review Will in detail with J. A. G. during the next 3 months and especially 6 months before retirement from service. *J. A. G.*

2. A personal review in detail with you is necessary at this time regarding specific details and estimates on all investments and financial goals. An appointment on approximately 15 October would be most worthwhile.

223b

Ex. 204 (cont.)

3. None of the income generated includes a systematic withdrawal of our Investment Companies. This should be considered upon retirement.

Comment:

Captain Stay, I am certain our ideas on this balanced approach to investing will not only prove interesting but also profitable over the next few years. Our overall performance must continue to be outstanding for you.

Sincerely,

David M. Adam, Jr.
Associate Manager

pf

4/9/63

STAFF MEETING

Car: How to go back to man who has been involved on R.E. Synd. or when one wants to cancel:

What, Cancel! - It's all sold out, I just wanted to tell you how lucky you are - I wish you could get more - What the problem?

Which is most imp. Logic & Emotion.
Sell on emotion - Hit on Hot Button

NIGHT: SEC Allegations

- (1) Don't defend against
- (2) We along with MLPPS & BACHS were invited to important hearing - a 1,600 pg report was written
- (3) Go into ADH transcript of actual testimony - Do you want to hear
- (4) Don't make a big thing out of it and the client credit
- (5) We're all for the SEC survey

From the Desk of:

JAMES F. HAYHT

Lack of proper coordination and professional advice is the latest shortcoming in most men's savings-investment effort.

So in addition to rendering all the services of a Stock-broker, we also offer a Financial Planning service, without additional cost, to clients.

What is Financial Planning? Well, as the name implies it is a method of integrating many factors such as, tax bracket, pension income, inflation, retirement plans, children's education, social security benefits, insurance needs, etc., into one over-all Financial program with specifically-defined goals.

Sounds complicated?... Possibly so, but when striving for something as important as financial independence... something we all want and need - it might be a good idea to take a few minutes to see what we have to offer. Then you can decide if we can be of service to you.

I will call you soon to see when it would be possible for a brief interview. I'm sure you will find our plans not only interesting... but profitable.

Sincerely,

COLD CALL:

John Smith
"Dr. Jones, this is John Smith - I'm a stock broker here in Washington with Hodgdon & Co. --- Do you have a moment? Let me tell you very quickly why I'm calling --- We have many professional men, like yourself, as clients - - and who have found our ideas on investing very profitable. - - - Let me ask you, Doctor - - do you at the present time have a good stock broker or a high-grade investment program?"

(If he hasn't - or even if he has and shows any interest at all - the following):

"May I do this. ~~and~~? - - May I send you my card along with our letter on Financial Counseling - - then the next time I'm going to be in your area I'll give you a call to see if we can get together for a few minutes. Let me add very quickly, ~~Doctor~~, that there is no obligation whatsoever - I merely want to give you enough information on the type of work we do so you'll be able to judge whether or not you could use our services.

- or -

"I'm not sure we can help you, ~~Doctor~~, but we'd certainly like to try. "

Then send card and financial counseling letter and a note (handwritten) saying - you'll look forward to talking with him.

10/25/62

227

INSURANCE - SMITH

NET COST: Ins

3000
10
2000
STRATEGY WITH CLIENT: Get his cash first, then go after insurance; our only purpose in discussing insurance is to free more money -

He should be sold on F. P. & concept of managed money before we sell him on changing policies or borrowing or selling out of insurance

Have you seen your ins. analyzed by any one other than Life Ins. Industry - We may be able to get you more insurance; or save you money; & even have avail more to spend.

INSURANCE ASSOCIATED WITH CONTRACTUAL PLAN

Group Ins. with funds is cheaper per gross premiums than commercial over 10 yrs -

Cost of Ins. in Plan is part of cost basis & therefore reduces gap between cost & final amt. that has to be declared for long term capital gains -

There is no waiver of premiums under fund-ins. agreement - If holder is disabled can't continue M.F. he loses insurance

7/17/63

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A.D.H. = Indiv. Stocks

Are presently investing? (They are playing wht, gambling, etc & to suggest that they submit to Plan or program would be to alienate them -

Step 1: Qualify him, Find out what he is - What is he doing - What is his strategy

Don't be too concerned over making an appointment. This may scare him

Don't be too formal

"I'm doing a little investing" - Well I sure hope your investing has been better than mine - I bought 100 share of XYZ stock & in a rising market it hasn't done hardly a thing -

(Tell him what we are to find out what he is - To open him up)

Tell him about one of your best traders or one of your relatives -

If he bumps for long pull - "I wish I did that more often - It sound sensible & has proven satisfactory, but I'm usually driven by impulses that make situations look good at a given time

One Key to new prospect on Phone:
"I have a long time friend at Orvis Bros."
That's fine - I've heard of him & Orvis
Bros. But no one has a franchise on
good ideas - We don't have 30 good ideas
no. But we do ~~too~~ offer some unique
insight to stocks - When we have another
idea in writing I'll send it to you -
You'll like it - Is that OK

EXHIBIT #252 (cont.)

228a

"The Brokerage business today is a business of convincing 'Cowards'."

A.D.H.

Not enough attention is paid to subconscious mind of client or prospect - Insurance industry does this e.g. appeal to emotions -

Principle of Self Damage = Why do people approach stock market - for financial success, retirement, better return, or to gamble as they would at race track - Not all people can be reformed or convinced to do F.P. Don't fight him that is subconsciously trying to damage himself - Don't waste time on those who won't accept F.P. theory -

M. F.

Mr. ——— there are over 300 funds; me.
 at Washington have selected 15
 We think the one that will fit your needs
 is Abbeville fund. Why?? Because of
 management (Bilson) & record - Use the next
 quarterly report to drive home.
 is blue chip fund

44% of all research done in country are
 done by companies listed in Abbeville.

Quotes

- 4 chips are
 "choice to grow"
 "Built in Wagent."
 "Share in Amer. Industry"
 "Dividends earning dividends"
 "Cash money given day"
- (5) No details to worry
 (6) Millionaire are
 doing it - they are not -

ILLUSTRATIONS

- (1) Cow/milk - Dividends; Cow/calf - Cap. Gain
 (2) One well known man in community asking for
 1000 is 10 well known men asking for 1,000
 (3) Investment rubber co. with making in the
 doing well. but next year someone expects a
 little higher rubber price. large entirely. But M.F.
 say own stock rise. but if this happens
 they are hurt lost because they own 50.00

SECURITIES AND EXCHANGE COMMISSION
 FILE NO.
 IN THE MATTER OF: Hodges & Co.
 Respondents
 Commission's EXHIBIT No. 258

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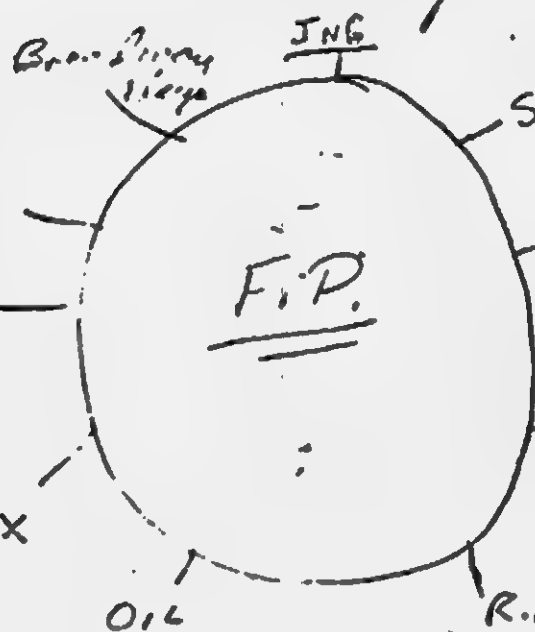
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25

Brook: Happy to have the opportunity to talk with you - Don't know if I can help you but would like to try.

Text: Mr. & Mrs. Doylan - Financial Planning with use of many diff. tools.

MIN



① We have an insurance man on our staff for advice. But we don't sell insurance.

② Stock & B: do \$5

③ Oil: Mention 5 to 15 a share

④ K.E. Syndication: -

Now people can invest in K.E. with limited cap. Pop 10% - 1/2 Tax free.

⑤ Underwriting

You can see from above that we have a wide range of investments to fit your needs.

(Appeal to Greed or Fear) -

The reason this work is profitable (in the long run) is

because we can help people. According to

research of the last 100 years -

in the world of this happens

only one in 1000 accumulate wealth of \$25,000 or more

if they save 10% of their income for 10 years

BEST COPY AVAILABLE

from the original bound volume

8/31/63 - Carr

If I get the answer how many shares do you want ?? (Reply to a difficult question by client or prospect usually)

Data Sheet

Most Imp: What he has to work with, cash etc

2nd Most Imp: What are his objectives

Set up so the prospect will be able to answer easily, get more personal on back

What are his dreams, where is he going
- his will be key in enabling us to sell him

Don't linger on Insurance

R.F.: Want to know value of prop, cash in the project, & net return so we can compare his return as compared to ours -

Two Obj:

General \equiv Educational, etc

SECURITIES AND EXCHANGE COMMISSION

IE 10.

Commission's EXHIBIT No. 259

Respondent's Page 1

IN THE MATTER OF:

Hodgdon Co.

DATE: 8-23-66

WITNESS: SAPPOR

ACE FEDERAL REPORTERS, INC.

By L R WEINSCHEL

(name of reporter)

8/3/63 - Piper - Staff Meeting

Secondary on 1st Western Financial
 \$2,000,000 shares out
 Price \$40 new (OTC)

Be available about 23rd Sept.

Financial Holding Co - 150 million assets
 Earnings of \$1.50 ~~per~~ before reserve excluding

Haight - Check sales presentation

Remember 5 points:

- (1) Intro
- (2) Appeal to Fear (of loss, inflation etc.)
- (3) Hope of Gain (appeal to greed)
- (4) Set for him a goal
- (5) Ask for the business - Tell him what to do -

ADD = Weissentenger Article -

Stocks: (1) Columbia Pictures, earn \$1.50 per sh.
 exclusive of Screen Gen Earnings.
 1st yr for long time Col. Pict has
 earned more
 (2) 20th Century
 (3) MGM

IN THE MATTER OF:

DATE: 8-23-66 WITNESS: S.A.P.C.E.R.

11-10

SECURITIES AND EXCHANGE COMMISSION

Commission's Form 100, 260

Revised 2-66

Hodges & Co.

All 3 Co. have released major motion pictures that should begin to contribute greatly to earnings - Book values are high

Explanation of M.F. :

This is exactly the same way of investing that a wealthy man, Rockefeller would invest. Here investment counselor to select portfolio of hi quality stocks & give constant supervision. Now consider yourself a poor cousin - Here are the stocks - Now of course you can't buy these - But suppose Mr. L. & his adviser allowed you to buy \$50,000 worth -

Gold Issue : Discuss it - Learn more about it

Forbes article on Shipping Center : They said that 15% of all centers are yielding avg 6% But, if so doesn't it mean that the 8% Center created is better value than when created -

11/12/63

233

EX. 290

STAFF MEETING

HAIGHT:

Sense of Urgency - Find legitimate reason that will make sense to him -

What would you think of Co., one of oldest in industry, paid div. every 90 days with out, even during the Depression (paid with post office receipts) - But yet during the last 15 years has given you 500% ~~interest~~ growth on your money? Sound like something you would be interested in?

What's more this same investment would reinvest your dividends so no. at no cost

In addition if you need some of your money you ~~can~~ can take out 90% of it with a cost & put it back in later when able at no cost.
In addition, etc.

Stop, Smile, & pay man a compliment when in a tight spot -

Ex. 290
(Cont.)

Is the ~~the~~ M.F. Cost really such an investment.

233a

Is the cost of an M.F. really a cost or an investment - If you want to send your children to college is that an investment or cost

If you put \$5,000 in & 3 years later its worth \$8,000 has the change been a cost or really an investment in your future success -

Tell the client your thoughts or ideas on his program even though he can't take -

HONESTY & SINCERITY

"You had better buy it, before it goes up - You can't ~~buy~~ make any money after it goes up -"

Page Five

Dr. Charles E. Broadrup

Special Situations

No. of Shares	Security	Cost	Value	Income	Yield
11	Apache Corp.	\$ 275.00	\$ 121.00	-	-
	Joint registration.				
50	Avenco Corp.	400.00	87.50	-	-
	Single account #4193, purchased 11/29/61				
20	Basic Industries	409.00	10.00	-	-
105	Farmers & Mechanic	2,222.18	5,145.00	\$ 168.00	3%
	Joint registration - 50 on 1/31/53 - 1530 #F02265				
	25 on 4/9/55 - 737 #F02730				
	30 on 3/29/57 - 1550 #F02730				
	105		3617		
	63				
	105		3617		
	Unit cost is \$22.14 per share. 63 x 22.14 = 1,394.82				
	3617 - 1,394.82 = 2,222.18				
20	Fred. Prof. Bldg.	11,500.00	14,000.00	-	-
	10 shares own name 1/3/49 #45 - \$5,000.00				
	10 shares joint-gift to Mrs.				
	of 3,250 on 12/11/59		6,500.00		
			\$11,500.00		
200	Kent Washington	1,000.00	500.00	30.00	6%
	Single registration				
17	Oil-Canadian 1951 (after taxes)	8,075.00	20,000.00	1,200.00	1.3%
	Tenants in Common with wife. Potential worth: \$100,000				
1	Oil-Canadian 1952	2,600.00	13,000.00	1,000.00	4.0%
	Tenants in Common with Mrs. and Harper,				

EXHIBIT # 447

235

HODGDON & CO., Inc. STOCKBROKERS

411 K STREET, N.W., WASHINGTON 5, D. C. • STERLING 3-8040
Corners Shopping Center, Falls Church, Virginia • JEFFERSON 4-8800
1929 Arlington Road, Bethesda 14, Maryland • OLIVER 4-6260

• FINANCIAL PLANNING
IN SECURITIES
• PROFIT SHARING
• REAL ESTATE SYNDICATIONS
• INSURANCE RESERVES
• OIL PROGRAMS

January 30, 1961

Memorandum

To: Officers - Hodgdon & Co., Inc.
From: W. Lyles Carr, Jr. and James F. Haight
Subject: Thoughts For Discussion

1. Emphasis and Direction in the Individual Stock Area

- a. Listed. - At present time representatives seem to be at a loss to recommend or to know how to go about finding individual listed stocks to recommend to clients or prospects who request them.

It is well understood by representatives that the individual "blue chip" area should be handled by the professional management of Investment Companies or thru the David Babson Investment Counseling firm. But in initial conversations with prospects it is important to be able to discuss intelligently selected listed securities.

We don't think a great deal of listed securities would be sold because 1) of low commissions and 2) greater emphasis in other situations; but, it would show that we didn't have only high commission situations.

Recommendations:

Occasionally short talks at meetings telling what "blue chip" securities the Investment Companies are buying and selling or what Hodgdon & Co. recommends. Information for such a meeting gained from Wiesenberger, etc. and more importantly thru personal contact with the funds. +

b. Special Situations

(1) Representatives are having a difficult time keeping themselves adequately informed on the firm's previously recommended "Special Situations" and as a result cannot satisfactorily answer clients questions or feel comfortable about having their clients in such situations.

have their reports, and I don't want you to get the impression that everything in the reports, and they are quite lengthy, is on the dark side; they also complimented you in certain areas where it was on the plus side, but there are a number of things that we are sure the Committee will want to know a little bit more about. You are certainly not the typical non-member firm with a lot of commission business. The percentage of your commission business to your total is very small. Over the four-year period the income came largely, as I see it, from underwritings, about a third of which were in real estate participations and in the sales of mutual funds. Were they primarily front load funds, contractual plans or was that only a part of them?

MR. HODGSON: That was only a part.

MR. COYLE: You have engaged in some, at least to us, unorthodox methods of doing business, and you will forgive me if I seem hypercritical of some of them. At least from my point of view, I question the business policy involved in some of them. You had developed a rather sizable sales force who we find, as a result of our inspection, are left largely on their own with very little if any supervision. It's true that you are not--

MR. COYLE: Yes, sir.

MR. HODGDON: You asked me if it is not true our attraction to registered representatives is a higher pay scale; I would say that is a correct statement. When we interview men for jobs with our firm we do not discuss commissions or rates of commissions with them, and they join our firm because they like the image of our firm through advertising. We have not had to try or compete with other firms on a commission basis.

MR. WATERBURY: Aren't they interested, when they apply aren't they interested in what their commission percentage will be?

MR. HODGDON: No, not particularly. I imagine they assume we pay as everybody else pays or similar to that.

MR. BISHOP: Are these people who have been in the securities industry before?

MR. HODGDON: Primarily not; that's probably the best answer to the question.

MR. COYLE: How are you going to solve the problem if you become a member organization if such persons have to be trained for six months before they can become productive?

MR. HODGDON: I imagine the way other member

7:30 AM

MON

Wed

FRI

EXHIBIT # 554

238

HODGDON AND COMPANY NEWS FORMAT
September 12, 1960

PEN: Hodgdon and Company, 1411 K Street, N.W. present the latest world news. This summary is presented as another service of Hodgdon and Company, specialists in financial planning.

LE: Don't waste fear any more than you would waste your money. We say this because fear, that's right, fear of facing money and the future often leads to wild unthoughtout investment action. Hodgdon and Company offers a brochure which helps explain the reasoning --- or rather the lack of it --- behind fear of money and the future. But don't let your financial future down with impulsive investment action. Call in an investment expert, one of the many informed specialists at Hodgdon and Company. Investigate the many services of Hodgdon and Company. Call or stop in at Hodgdon and Company, 1411 K Street, N.W. and ^{their current} ask for a free copy of "Finance Counselling" ^{NEWSLETTER}. ~~a booklet by Hodgdon and Company to introduce you to correct finance~~ ~~counselling and the technique of handling money without fear of~~ ~~the future.~~

SE: Hodgdon and Company has presented the late news bulletins. Listen also at 5:30 PM Monday through Friday for the WGMS stock market report, another service of Hodgdon and Company, specialists in financial planning, at 1411 K Street, N.W.

EXHIBIT
#556

239

Effective December 15, 1960 ✓

Re: Hodgdon & Company, Inc.

60-second spot:

#1

I just want to tell you briefly what a pleasant experience you have in store when you drop into one of Hodgdon & Company's offices and discuss your investment program. First, you'll be welcomed by a counsellor who is an expert in financial planning in the field of securities--profit sharing--insurance reviews--and oil programs. Second, you will get his undivided attention to your present portfolio--and his suggestions on how it might be improved. Or, if you're a new investor, he'll get you off to a sound start. Third, you'll find this counsellor a man to like personally and trust implicitly. So why not stop in at one of Hodgdon & Company's offices at 1411 K Street, Washington; in the Seven Corners Shopping Center in Virginia and at 6929 Arlington Road opposite Bradley Shopping Center in Bethesda. You'll find it time well invested. That's Hodgdon & Company, Sterling 3-8040.

EXHIBIT
557

240

Effective December 15, 1960

Re: Hodgdon & Company, Inc.

60 Second spot - 1/2

May I give you an invitation from our sponsor? Hodgdon & Company would like to issue a special invitation to new investors...those of you who have been putting off the matter of putting your savings to work with a sound investment plan. Well, let me promise you this--when you talk with a Hodgdon & Company representative about investments your eyes will really be opened to a fascinating field of financial opportunities--~~for long range gain--immediate gain--whatever best suits your individual needs.~~

And please don't think you have to be a millionaire to be an investor. Almost half of all shareholders are people in the \$5000 to \$10,000 annual income bracket. So why delay that visit to Hodgdon & Company another day? Drop in at their main offices, 1411 K Street, or their Bethesda office at 6929 Arlington Road opposite the Bradley Shopping Center and in Virginia at the Seven Corners Shopping Center. Put the name--Hodgdon & Company, your personal investment counsellors at Sterling 3-8040.

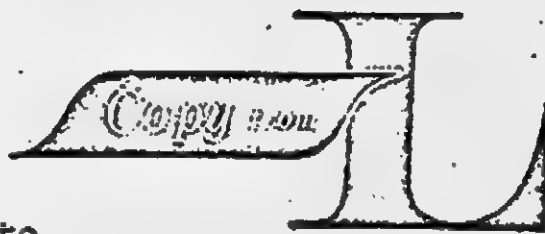
CLIENT: HODGDON & CO.

MEDIUM: RADIO

DATE: 1 MIN. SPOT

SIZE: SCHEDULE RATE 1, 2, 3, etc.

POSITION: SUPERCEDE PREVIOUS SPOT, T.F.



Larrabee Associates Advertising
1145 19th Street, N.W., Washington 6, D. C.
Federal 8-8800

P. O. NO.

EXHIBIT #573

Ray. Dec 26

SPOT #1

Here's a New Year's Resolution with its own built-in reward...
an early visit to Hodgdon and Company Investments, and a talk
about your financial future. Hodgdon and Company has no crystal
ball but they do have a research staff that has thoroughly and
competently analyzed ~~the~~ the probable course
of the market, new and old issues of interest, mutual funds,
growth stocks -- in short, they have an across-the-board picture
of 1962's business trends. More than that, Hodgdon's trained
representatives can translate this broad outlook into the very
practical terms of what it means to you and to your investment
portfolio. Counselors at Hodgdon and Company will be delighted
to consult with you at your convenience, always confidentially
and without cost or obligation on your part. A wise resolve,
then, would be to include Hodgdon and Company in your immediate
financial plans. You will also find Hodgdon's newsletter
"Action Makes the Difference" an intelligent asset - write or
phone for a complimentary copy now. Why not start '62 with the
best resolution of all - a visit to Hodgdon and Company Investments
...downtown Washington at 1411 K Street, Northwest...the phone
number is STerling 3-8040. Or stop by one of Hodgdon's conveniently
located suburban offices: in Falls Church, Virginia, in Seven Corners
Shopping Center; or in Bethesda Maryland, opposite the Bradley
Shopping Center on Arlington Road.

242

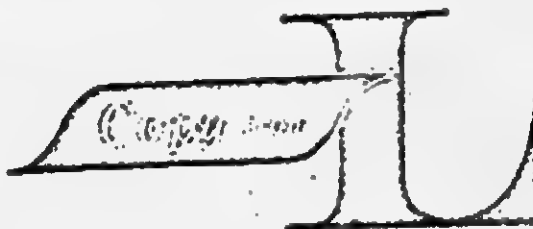
HODGDON & CO.

RADIO

1 MIN. SPOT

SCHEDULE RATE 1, 2, 3, etc.

NOTE: SUPERCEDE PREVIOUS SPOT, T.F.



Larrabee Associates Advertising

1145 19th Street, N.W., Washington 6, D. C.

FEderal 8-8800

P. O. NO.

EXHIBIT
574

SPOT #1

Here's a New Year's Resolution with its own built-in reward... an early visit to Hodgdon and Company Investments, and a talk about your financial future. Hodgdon and Company has no crystal ball but they do have a research staff that has thoroughly and competently analyzed the probable course of the probable course of the market, new and old issues of interest, mutual funds, growth stocks -- in short, they have an across-the-board picture of 1962's business trends. More than that, Hodgdon's trained representatives can translate this broad outlook into the very practical terms of what it means to you and to your investment portfolio. Counselors at Hodgdon and Company will be delighted to consult with you at your convenience, always confidentially and without cost or obligation on your part. A wise resolve, then, would be to include Hodgdon and Company in your immediate financial plans. You will also find Hodgdon's newsletter, "Action Makes the Difference" an intelligent asset -- write or phone for a complimentary copy now. Why not start '62 with the best resolution of all -- a visit to Hodgdon and Company Investments ...downtown Washington at 1411 K Street, Northwest...the phone number is Sterling 3-8040. Or stop by one of Hodgdon's conveniently located suburban offices: in Falls Church, Virginia, in Seven Corners Shopping Center; or in Bethesda Maryland, opposite the Bradley Shopping Center on Arlington Road.

243

NT: HODGDON & CO.

UM:

RADIO

1 MIN. SPOT

CHEDULE:

ROTATE 1,2,3, etc.

TION:

Larrabee Associates Advertising

1145 19th Street, N.W., Washington 6, D. C.

Federal 8-8800

P. O. NO.

SUPERCEDE PREVIOUS SPOT, TP

EXHIBIT #575

SPOT #4

And now a question from Hodgdon and Company, Investments:

What will 1962 bring you? It is entirely probable that it could bring prosperity and start you on the road toward financial security, if you start 1962 with a visit to Hodgdon and Company. Financial planning and counseling are part of the Hodgdon services that are available to you. Trained investment analysts will go over your present portfolio and make any necessary suggestions. Such advice is based on Hodgdon's own vast experience in the financial field and their constant contact with other leading investment companies. Naturally, this advice is both confidential and without cost or obligation on your part. Why delay? Talk to our trained representatives about the financial outlook for '62, and most particularly, about your own financial outlook, which can be bright indeed with the sage counsel afforded by Hodgdon and Company. And, write or phone for your complimentary copy of Hodgdon's newsletter "Action Makes the Difference". Hodgdon and Company is located at 1411 K Street, Northwest...the phone is STerling 3-8040. In Falls Church, Virginia, there is a Hodgdon and Company office near you at the Seven Corners Shopping Center, and in Bethesda Maryland, opposite the Bradley Shopping Center on Arlington Road.

EXHIBIT
#615

244

HODGDON & COMPANY

SPOT #62-1

Opportunity...far from knocking just once...knocks many times. In fact, it is a continuous process when you are a customer of Hodgdon and Company, Investments. Registered representatives at Hodgdon are always alert for new opportunities for investment, while never forgetting long-established stocks, bonds, mutual funds and the like. In short, a balance is maintained between the new and the tried-and-true. Why not stop by one of Hodgdon and Company's three offices, and discuss your investment future with a registered representative. He will show you -- without any obligation on your part, of course -- how to get the most from your investment dollars. Such suggestions must be hand-tailored for each customer, but this care pays off for you, in providing you with an investment portfolio that is sensible, sound, geared to your present needs...and yet provides opportunity for growth. Why delay -- a visit to Hodgdon and Company can be a financially-rewarding one. That's H-O-D-G-D-O-N...and Company, 1411 K Street, Northwest, phone STerling 3-8040, or visit the conveniently located Hodgdon and Company suburban offices...in the Seven Corners Shopping Center, Falls Church, Virginia, or in Bethesda, Maryland - opposite the Bradley Shopping Center, on Arlington Road.

EXHIBIT
#616

245

HODGDON AND COMPANY

SPOT #5

Here is a special message for you from Hodgdon and Company ...
investments:

Do you know what a procrastinator is? That's a person who puts things off. And of course, it's a fact that most of us do put things off occasionally. But there's a danger in certain kinds of procrastination...for instance, financial procrastination. There's only one way to assure tomorrow's security...that's by preparing today...right now! We realize, of course, that this is quite an order for the average individual. Many of us wouldn't know where to begin. But assistance is yours for the asking. Hodgdon and Company... investments...prides itself on being able to help you secure a future for yourself and your family. Advice on individual stocks is freely given, based on Hodgdon's vast experience in the financial field and their constant contact with leading investment companies. So why not stop putting things off? Act today! Call, write or visit Hodgdon and Company...1411 K Street, Northwest...in Washington...or phone STerling 3-8040. Hodgdon offices also conveniently located in Falls Church, Virginia...at the Seven Corners Shopping Center, and in Bethesda, Maryland...opposite the Bradley Shopping Center on Arlington Road.

247

EXHIBIT
13B

SECURITIES AND EXCHANGE COMMISSION

DOCKET NO.

31 Pa. 13-B

SALES QUOTA SYSTEM: THIS MATTER OF: Hodgdon

DATE: 5-24-67 WITNESSES: Naigle

ACCEPTED FOR REPORTS, INC.

By [Signature]
(name of reporter)

As of November 1, 1962 Hodgdon & Co., Inc. will institute a "Sales Quota System" as follows:

1. Any representative of Hodgdon & Co., Inc. who has been with the firm one year or longer shall sell \$18,000 in mutual funds or its equivalent each month such as:

- a. \$18,000 in outright purchases.
- b. One \$100 per month 15 year mutual fund plan.
- c. Two \$50 per month mutual fund plans.
- d. One \$50 per month plan plus \$9000 outright purchase.
- e. Four \$25 per month mutual fund plans.

-or-

2. Five plans (either 10 year or 15 year) of any denomination in each two month period.

-or-

3. Earn net commissions to himself of \$600 per month from investment sales of a high-quality - high-quality meaning other than selling or trading in low-priced speculative securities. The final decision on "high-quality" shall be determined by the Corporation Officer in charge of sales subject to the review of the Board of Directors of Hodgdon & Co., Inc.

The above goals can be averaged over the two months but cannot be carried over beyond each two month period.

The results for each registered representative shall be reviewed every two months. Those representatives who do not meet the above monthly average for any two month period will be subject to dismissal from the firm.

Supplement to "Sales Quota System"

The Sales Quota System is not intended to cause any representative to feel undue pressure or insecure in his investment career. Rather it is intended to give a sense of urgency to those who have completed their training and have a full year in the investment business but still are not working. A survey of all representatives earnings over the past five years points out that if the representative makes a "presentation" to only one person per day (which is half of the number the representative should have seen) his average earnings will be far in excess of the minimums required.

Also, an analysis of those representatives who failed in the investment business points out that all of them had made a sales presentation to less than 1/2 person per day on average - they simply didn't work!

In addition it has been found that any representative earning less than the minimums stated after one year in the investment business is extremely disappointed with himself and his career and if he continues on, becomes totally ineffectual. He attempts to find excuses to rationalize his failure and becomes a severe critic of the investment industry, the firm, and his associates. His very presence in the firm at this stage is certainly less than desirable.

The last point to be made is that as of January, 1963 the Stock Exchange will allow its members to have only full-time representatives and one major criterion to distinguish between full-time and part-time will be the representative's average monthly earnings.

The investment business offers all representatives a fascinating career - one in which a great sense of personal accomplishment can be achieved. All the Sales Quota System is expected to do is help the representative through the "gray areas" between success and failure and on to the almost limitless heights offered to anyone who makes a sincere effort.

James F. Haight

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos.
71-1136
23,244
23,246

United States Court of Appeals
for the District of Columbia Circuit

FILED JUL 2 1971

Nathan J. Paulson
CLERK

HAIGHT & CO., INC., ET AL.,

Petitioners,

-v-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

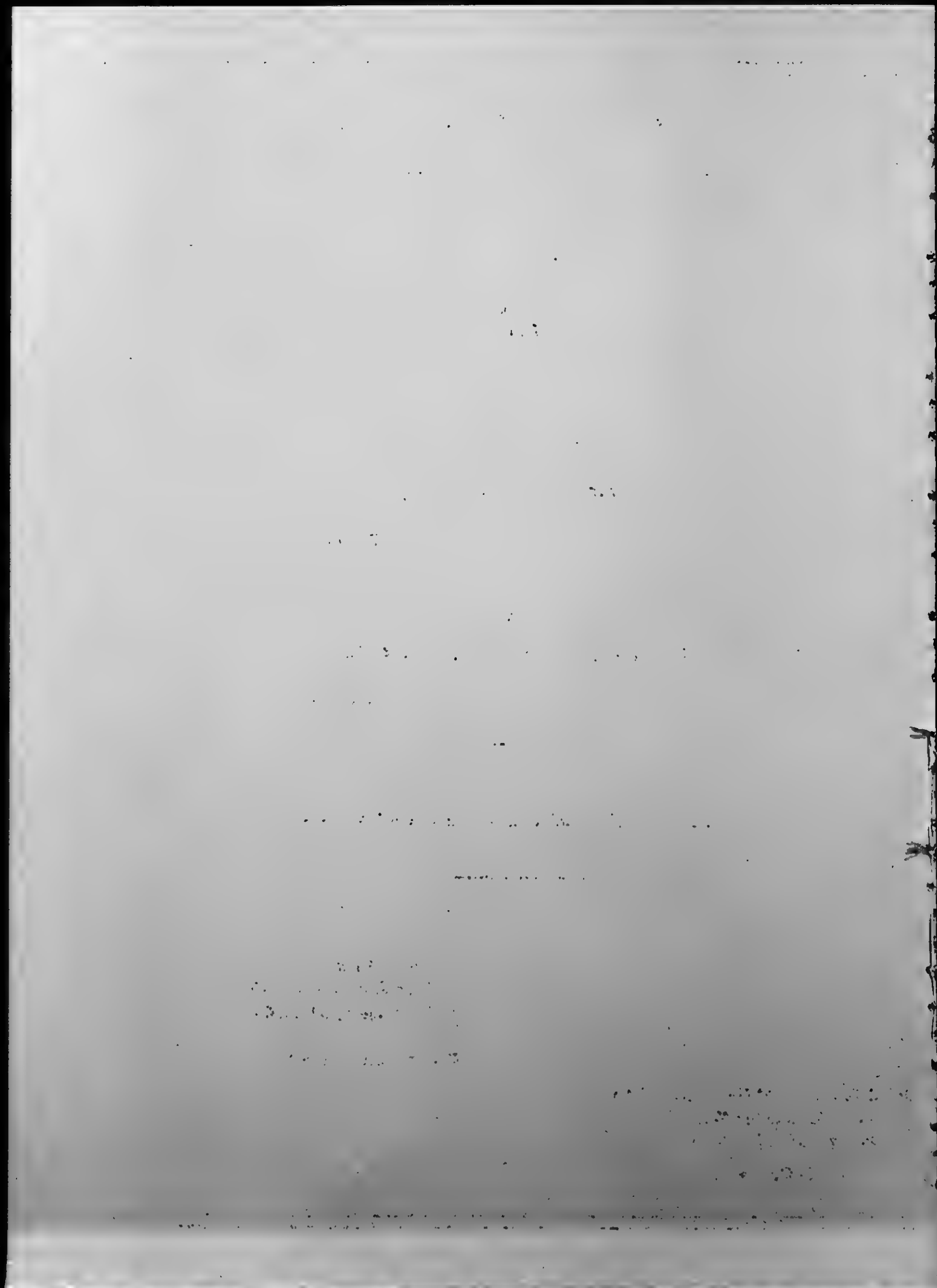
REPLY BRIEF FOR PETITIONERS

Sidney Dickstein
Federal Bar Building West
Washington, D. C. 20006

Attorney for Petitioners

DICKSTEIN, SHAPIRO & GALLIGAN
Federal Bar Building West
Washington, D. C. 20006

Of Counsel



CITATIONS

Cases:

* Carey v. C.A.B., 275 F.2d 518 (1 Cir.)	15
Collier v. Mikel Drilling Co., 183 F.Supp. 104 (D. Minn.)	19
* Columbia Broadcasting System v. United States, 316 U.S. 407	17
Consumers Power Co., 6 S.E.C. 444	18
Klein v. S.E.C., 224 F.2d 861 (2 Cir.)	13
NLRB v. Bradley Washfountain Co., 192 F.2d 144 (7 Cir.)	8
* Northeastern Indiana Building & Const. Tr. Coun. v. NLRB, 122 U.S. App. D.C. 220, 352 F.2d 696	8, 11
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* S.E.C. v. Chenery Corp., 318 U.S. 80; 332 U.S. 194	15
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* United Packinghouse, Food & Allied Workers v. NLRB, 135 U.S. App. D.C. 111, 416 F.2d 1126	8
* United States v. Wiley, 267 F.2d 453 (7 Cir.); 278 F.2d 500 (7 Cir.)	21

Statutes and Regulations:

17 C.F.R. § 206(a)	8
17 C.F.R., Part 231	19
11 Fed. Reg.	16
5 U.S.C. § 551(1)(4)	17
5 U.S.C. § 553(b)(3)(A)	16
5 U.S.C. § 554(b)(3)	8
15 U.S.C. § 77s(a)	18
15 U.S.C. § 78f	12
15 U.S.C. § 78o-3	12
44 U.S.C. § 304	17
44 U.S.C. § 305(b)	17
44 U.S.C. § 1501	17
44 U.S.C. § 1505	17
44 U.S.C. § 1507(1)	17

Miscellaneous:

Brenner, Selected Jury Instruction Forms in an SEC Criminal Case, 41 F.R.D. 93	19
H. R. Rep. No. 1542, 83rd Cong. 2d Sess. 19	19
* Loss, Securities Regulations	12, 19
* NASD Manual (CCH Ed.)	13
Orrick, Some Observations on the Administration of the Securities Laws, 42 Minn. L. Rev. 25	19



UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nos.
71-1136
23,244
23,246

HAIGHT & CO., INC., ET AL.,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

REPLY BRIEF FOR PETITIONERS

Preliminary Statement

For convenience, our reply brief follows the format of the Commission's answering brief. As refined on appeal, there are four charges against petitioners: (1) that they engaged in a "scheme to defraud" (R.Br. ^{1/}49-56); (2) that they made fraudulent statements in the sale of securities (R.Br. 57-61); (3) that they sold unregistered securities (R.Br. 62-67); and (4) that they committed other--essentially "record keeping"--violations (R.Br. 68). We treat these charges seriatim in Part I of this reply brief. In Part II we turn to the issues which arise in the sanction phase of the proceeding.

I.

A. The "Scheme to Defraud" Charge

The "scheme to defraud" which the Commission ultimately found consisted, we are now told, of "two interrelated elements" (R.Br. at 49). First,



petitioners solicited investors in accordance with registrant's "financial planning" program (R.Br. at 49-50). Second--and the heart of the charge, since we assume that the Commission will concede that it is not unlawful for a securities firm to solicit patronage--petitioners "recommended securities * * * that were purposefully designed to bring petitioners a large measure * * * of 'high-commission' business" (R.Br. at 50). As the Commission's general counsel puts it "'financial planning' was by its conception and nature a device to sell high-commission securities * * * " (R.Br. at 52, n. 42).

This "scheme to sell high-commission securities "bears no resemblance to the "scheme to defraud" that was charged in the Order for Public Proceedings and tried for 108 days before the Hearing Examiner. Thus, without more, this charge cannot be sustained on appeal; but there is more, for the charge which the Commission found and which it seeks to sustain in this Court is not even a violation of law!

1. Petitioners Were Not Charged with a Scheme to Sell High-Commission Securities

The "scheme to defraud: set forth in the charging order (later supplemented) consisted of 15 very specific allegations (J.A. 17-19), none of which alleged that petitioners schemed to sell "high-commission securities." We treat the specifications seriatim.

First, petitioners were charged that they did:

(1). permit, engage and arrange for the employment as salesmen for registrant of individuals who had little or no prior experience, training or qualifications as securities salesmen and permit, encourage and arrange for registrant's salesmen to advise customers regarding their finances including securities investments, real estate, taxation, trusts and wills, oil and gas, and insurance without suitable training in such fields and without suitable training or indoctrination in the standards of conduct required of those engaged in the securities business (J.A. 17).



This charge related to alleged inadequacies in registrant's training program. It did not refer to a scheme to sell high-commission securities.

Next, petitioners were charged that they did:

(2) induce inexperienced and unsophisticated customers to repose complete trust and confidence in them, causing such customers to believe that they would act in their best interests in connection with all purchases and sales of securities (J.A. 17).

This charge did not put petitioners on notice that the gist of the scheme of which they stood accused was the sale of high-commission securities. In addition, since the Commission has now expressly held that it does not matter whether or not petitioners' recommendations for securities transactions were suitable and in the customers' best interests, this charge is also now seen to be immaterial to the scheme which the Commission found.

Next, petitioners were charged that they did:

(3) cause such customers to believe that respondents had skill, knowledge and experience in financial planning, including securities investments (J.A. 17).

This charge also failed to give notice that what was alleged was a scheme to sell high-commission securities.

Next, petitioners were charged that they did:

(4) induce customers, without regard to such persons' financial needs and objectives, to sell seasoned securities out of their investment portfolios and reinvest the proceeds in unseasoned and speculative securities in which respondents had direct and indirect interests, and

(5) fail to disclose to such customers the respondents' special interests in certain transactions; namely, registrant's commissions, charges and profits on securities transactions (J.A. 18).

These charges did not place respondents on notice that they were accused of scheming to sell high-commission securities. They alleged a scheme to sell unseasoned and speculative securities. The Hearing Examiner required that the Commission file a more definite statement specifying the "unseasoned and

speculative securities involved in these charges." Pursuant to that order,^{2/} the Commission specified no less than 44 securities. None of the 44 securities was found to be "unseasoned or speculative" and none of the specified securities were found to be securities in which petitioners had a "direct and indirect" interest. Indeed, out of the whole administrative record, the only security in which any of petitioners was found to have an interest was Aberdeen Fund, a conservatively managed mutual fund, and that security was not included in the more definite statement. General Counsel apparently now concedes that the portion of these charges which alleged that respondents failed to disclose their sales commissions was not proved (R.Br. 54).^{3/}

Next, petitioners were charged that they did:

(6) cause such customers to retain their trust and confidence in respondents by means of lulling letters and oral representations that they were better off because of the financial advice given by respondents, when, in fact, such customers had suffered losses or were no better off than before dealing with respondents.

^{2/} In response to the Examiner's order for a more definite statement, the Commission specified 28 securities which were the alleged "unseasoned and speculative securities" referred to in (4), and by a later supplement 16 more securities were added. Those securities were: Primex Equities Corporation, U. S. Infrared Corporation, Data Processing Corporation, Paragon Electrical Manufacturing Corporation, Van Pak, Inc., Capitol Properties, Inc., Toledo Plaza Limited Partnership, Rock Creek Limited Partnership, Cheverly Terrace Limited Partnership, Canandaigua Enterprises Corporation, The Connection Company, Mid American Life Insurance Company, Watson Electronics & Engineering Co., Inc., Metropolitan Security, Inc., Richmond Motor Lodge Limited Partnership, Falls Plaza Limited Partnership, Mount Vernon Apartments Limited Partnership, Big Fish Little Fish Limited Partnership, Lord of the Flies Limited Partnership, Jonkers Business Machines, Inc., Westfalls Shopping Center Limited Partnership, Kent Washington, Inc., Orbit Industries, Inc., Alex Forst & Sons, Inc., Glenn Rose Limited Partnership, Apache Canadian Oil & Gas Program 1961, Roseville Detroit Limited Partnership, Wise Homes, Inc., Mohawk Business Machines, Inc., Roseville Detroit Limited Partnership, Apache Realty Corporation, Transcontinental Investment Corporation, Tel-A-Sign, Inc., Vahlsing Corporation, Major Finance Corporation, Edwards Engineering Corporation, Swimming Pool Development Corporation, Thoroughbred Enterprises, Inc., Cooke Engineering Company, Sheraton Corporation (warrants), Mile Electronics Corporation, Brothers Chemical, Automation Labs, Beauty Counselors (J.A. 85-86, 94-95).

^{3/} It is ironic that the Commission stresses, at great length, the disclosure function of the prospectus when dealing with the separate issue of unregistered securities (R.Br. at 65) but seems to ignore that identical disclosure function with respect to Commission charges (R.Br. at 54-55).

This charge does not allege a scheme to sell "high-commission securities" and we are now told that it is not pertinent to the scheme which the Commission found because it is immaterial whether or not customers "were better off because of the financial advice given by respondents." It is equally immaterial, the Commission now asserts, whether or not customers "had suffered losses."

Next, petitioners were charged that they did:

(7) engage in the distribution and sale of speculative and unseasoned securities without first having made reasonable and diligent inquiry as to the true nature and worth of these securities, although on notice of facts and circumstances which made such inquiry essential and which inquiry, if made, would have revealed the background of the issuers, the circumstances surrounding their organization, and the history of these issuers as to their operations, earnings, dividends, current financial condition and other similar matters (J.A. 18).

This charge does not allege a scheme to sell "high-commission" securities, and in any event is immaterial, the Commission now says, for it does not matter whether petitioners "made a reasonable and diligent inquiry into the true nature and worth of these securities." Indeed, the Commission goes further and says that the "true nature and worth" of these securities is immaterial.

Next, petitioners were charged that they did:

(8) engage in the distribution and sale of securities to customers without disclosing their failure to have made the inquiries described above and their failure to obtain and disclose such material adverse information (J.A. 18).

This specification, which was not the subject of findings by either the Hearing Examiner or the Commission, is not pressed in this Court and has nothing to do with an alleged "scheme to sell 'high-commission' securities."

Next, petitioners were charged that they did:

(9) endeavor by the use of high pressure selling efforts

to place customers in a position where they were asked to make hasty decisions to buy securities upon the basis of incomplete, untrue, deceptive and unsubstantiated representations.

Standing by itself, this charge has nothing to do with a scheme to sell high-commission securities. In fact, as contrasted to a "boiler shop" operation, the deliberative consideration of investments which was essential to financial planning is totally inconsistent with "hasty decisions."

Next, petitioners were charged that they did:

(10) offer to sell, sell and deliver after sale the securities of U. S. Infrared Corporation (Infrared), Paragon Electrical Manufacturing Corporation (Paragon) and Data Processing Corporation (DPC) when no registration statement under the Securities Act had been filed or was in effect with respect to such securities (J.A. 18).

This is not a charge relating to the sale of high-commission securities.^{4/} Indeed, one of these securities (DPC) was sold at no commission at all and another, Paragon, was sold under an arrangement where registrant's commission was received not in cash but in stock valued at the same price at which the security was sold to its customers (Pet.Br. 44-45).

Next, petitioners were charged that they did:

(11) while engaged in the distribution of Infrared, Paragon, DPC and other securities and acting as a broker-dealer fail to send confirmations of certain of such transactions to customers at or before the completion of each such transaction (J.A. 18).

There is no finding by the Hearing Examiner or the Commission that petitioners failed to send a confirmation with respect to any of the listed securities, nor is such a charge relevant to a "scheme to sell 'high-commission' securities."

^{4/} Petitioners were separately charged with selling these securities when a registration statement was not in effect. That charge, which is not alleged to be part of the "scheme to sell 'high-commission' securities", is separately treated, infra, pp. 15-19.

Next, petitioners were charged that they did:

(12) participate in the operations of a securities selling organization in which the salesmen without suitable training in the standards of conduct required of those engaged in the securities business were permitted and encouraged to offer and sell securities to customers and fail to reasonably supervise salesmen who were subject to their supervision, with a view to preventing violations of the statutes, rules and regulations administered by the Commission (J.A. 18-19).

There is no finding that petitioners' salesmen were not suitably trained or that petitioners did not suitably supervise them. Nor does such an allegation have anything to do with a "scheme to sell 'high-commission' securities."

Next, petitioners were charged that they did:

(13) fail to make entries on the books and records of registrant for the purpose of concealing all or certain of the activities in paragraphs (1) through (11) above (J.A. 19).

There is no finding that petitioners failed to make entries on registrant's books and records for the purpose of concealing "all or certain of the activities in paragraphs (1) through (11) above."

Next, petitioners were charged that they did:

(14) make untrue, deceptive and misleading statements of material facts and omit to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading with regard to all or certain of the securities of Infrared; Paragon; DPC; Van Pak, Inc.; Roseville Detroit Limited Partnership; and Apache Canadian Oil & Gas Program 1961, concerning, among other things: (a) a rise in the price of such securities; (b) the earnings and financial condition of the issuers; (c) the use of the proceeds by the issuers; (d) the uniqueness or superiority of the products; (e) the rate of return from these securities; (f) the quality and safety of the securities; (g) the future prospects of the issuers; (h) the contracts held by the issuers; (i) the management of the issuers; (j) the market value of the securities; (k) the registrant's recommendation of such securities; (l) the future assessments on the securities; (m) the activities described in paragraphs (1) through (12) above; and other statements, representations, and omissions of similar object and purport (J.A. 19).

None of the 13 alleged false or misleading statements specified in Charge 14 have anything to do with "commissions" or "sales charges."

By a motion to amend the order for public proceedings, the Commission added a 14th charge. That charge provided that petitioners did:

(15) make false and fictitious entries and aid and abet the making of such entries on the books and records of the registrant in connection with the offer and sale of Van-Pak, Inc., securities in the State of Virginia (J.A. 98).

This charge, like the others, is wholly irrelevant to the alleged "scheme to sell 'high-commission' securities."

When the Administrative Procedure Act talks of notice of "the matters of fact and law [to be] asserted," 5 U.S.C. §554(b)3, it means fair notice. E.g., Northeastern Indiana Building & Const. Tr. Coun. v. NLRB, 122 U.S.App. D.C. 220, 352 F.2d 696 (1965); United Packinghouse, Food & Allied Workers v. NLRB, 135 U.S.App.D.C. 111, 416 F.2d 1126, 1134, n. 12 (1969); NLRB v. Bradley Washfountain Co., 192 F.2d 144, 149-150 (7 Cir. 1951). Implementing the Act, the Commission's own regulations require a "short and simple statement of the matters of fact and law to be considered and determined," 17 C.F.R. §206(a). Whatever else may be said about the Commission's order for public proceedings, we think it demonstrably plain that registrant and the individual respondents were not charged in a "short and simple statement" with a "scheme to sell 'high-commission' securities." The order itself and the entire history of the administrative hearing conclusively shows that the charges against petitioners rested on an allegation that petitioners defrauded their customers by recommending securities transactions which were not in their customers' best interests or in accordance with their customers' stated financial objectives.

Petitioners were not the only ones who were misled by the charges which General Counsel now says constituted adequate notice of the violations

which the Commission ultimately found (R.Br. 73-75). The Commission's own trial counsel, near the close of the Commission's case-in-chief, assured the Hearing Examiner that petitioners were not charged with "high markups" (Tr. 5825; 5513-5529). The Trial Examiner agreed. As he put it:

"I have had occasion to remark once before when similar matters were under discussion, there is no allegation on excessive markups" (Tr. 5824, 5826).

Indeed, when the Hearing Examiner ruled that evidence of a security's subsequent performance was irrelevant--a ruling which the Commission's General Counsel now says was correct (R.Br. at 51)--the Commission's trial counsel took an interlocutory appeal and succeeded in having the Examiner reversed by the Commission (J.A. ¹²⁰⁻¹²³~~340-349~~). At that point in the proceedings, the Commission concluded that the evidence was relevant because: "Subsequent market prices may be a factor together with other relevant circumstances in determining whether as alleged in [paragraph IIB(2)], the broker-dealer acted in the customers' best interests" (J.A. ¹²¹~~341~~) (emphasis supplied). As contrasted with its construction of the charges when confronted with the evidentiary issue, the Commission ultimately held that whether or not the petitioners had acted in their customers' best interests was wholly irrelevant (J.A. 324). And its General Counsel now tells us--directly contrary to the Commission's evidentiary ruling (J.A. ¹²¹~~341~~)--that it is "wholly irrelevant whether customers suffered losses or gains" (R.Br. at 51). The record thus conclusively shows that during the hearing stage of the proceeding, petitioners, the Commission's trial counsel, the Hearing Examiner and the Commission itself thought that the "scheme to defraud" rested on the allegation that petitioners recommended securities transactions which were not in their customers' best interests. It was only after the record was closed that the Commission shifted position and held that whether or not the securities recommended were in the customers'

best interests was irrelevant (J.A. 324).

From the foregoing, it is plain that petitioners did not have fair and adequate notice of the charges which have come to form the basis for the Commission's order now under review.

2. The Overbroad Proceedings Were Prejudicial

In addition to the lack of specific notice that petitioners were charged with a scheme to sell "high-commission securities," the charges and the proceedings were so overbroad that they obscured any semblance of an idea of that against which petitioners had to defend. The "scheme to sell 'high-commission' securities," which the Commission ultimately found, could have been simply stated in an order for proceedings and tried within a matter of days. Petitioners have never contested the fact that a large portion of their securities recommendations bore a commission higher than a standard exchange commission for a listed security. Indeed, as the Commission itself concedes, "there is, of course, nothing improper per se about the fact that certain types of securities--such as mutual funds and underwritten securities--carry much higher sales charges and commissions than do transactions in listed securities" (R.Br. 52, n. 42). Even if the "scheme to sell high-commission securities," which the Commission seeks to sustain here, is a violation of law--and as we show at infra, pp. 12-14), it was not--that charge was so buried in the plethora of other vigorously-litigated allegations that petitioners were deprived of a fair hearing.

The short answer to the Commission's suggestion that petitioners were not prejudiced by the lack of fair notice and the overly broad proceeding (R.Br. at 74-75) has been given by this Court:

"The Board now says that no harm was done because

petitioners presumably would not have defended themselves any differently. But this is a speculation we do not indulge. Lawyers customarily try cases by reference to the issues framed in the pleadings in advance of hearing, and not in anticipation of new issues which possibly may be announced by the [agency] in its opinion." Northeastern Indiana Building & Const. Tr. Coun. v. NLRB, supra, 352 F.2d at 699.

Petitioners' counsel spent literally weeks in adducing testimony designed to show that particular securities recommendations were suitable for the particular customer involved, and the Commission's trial counsel devoted weeks to showing that they were not. That charge, we are now told, is immaterial (J.A. 324). Both the Commission's trial counsel and petitioners' counsel spent many days adducing evidence designed to show that petitioners did or did not misrepresent the rate of return of real estate investments as alleged in the order for proceedings. That issue was resolved in petitioners' favor (J.A. 337, n. 50). Both the Commission's trial counsel and petitioners' counsel spent many days in an effort to show that the 44 specified securities allegedly involved in this proceeding (supra, p. 4, n. 2) were or were not "speculative" as alleged in the order for proceedings (J.A. 18). The Commission now tells us that the inherent worth of a security or its speculative nature is immaterial and that all the time the only issue was whether the security generated a high commission (R.Br. 51-52). Unaware that the real charge against petitioners was the "high commission" and diverted to other issues which were alleged in the order for proceedings but which now are claimed to have been immaterial all the time, petitioners were indeed prejudiced (see infra, p. 14, n. 8) by that which they were misled into not offering. An administrative hearing is not a "shell game" where the respondent is required to guess, at his peril, what charge is really being asserted against him. In this proceeding, it is clear that at no time until the Commission's final opinion did respondents have fair notice that they were charged with a "scheme to sell 'high-commission' securities" without regard to whether those securities were or were not in their customers'

best interests and without regard to whether respondents had a reasonable basis for making the securities recommendations at the time of the transactions. Standing alone, this requires reversal.

3. The "Scheme" Found by the Commission Does Not
Constitute a Violation of the Securities Laws

Leaving aside questions of adequacy of notice, it is not a violation of the securities laws for a broker to systematically stress securities which carry a higher rate of commission than other securities, for subordination of the customer's interest to the self-interest of the broker cannot be inferred from the fact that "high-commission" securities were sold to that customer.

Categorization of commissions on securities sales as "high" or "low" is an approach which is alien to the comprehensive body of regulation which governs the activities of broker-dealers. In the contemplation of the law, commissions are not "high" or "low"--they are "fair and reasonable" or "unfair and unreasonable." And whether a commission charged is "fair and reasonable" is a question which the securities laws commit to self-regulating organizations, to wit, the securities exchanges and the National Association of Securities Dealers ("NASD"). 15 U.S.C. §78o-3; 15 U.S.C. §78f.^{5/}

The underwriting compensation which a broker-dealer may receive in connection with the offering of a new security is not self-determined. Under Section 1 of the NASD's Rules of Fair Practice, the amount of commissions is reviewed by the NASD's Corporate Financing Department which applies certain

^{5/} The rules of these self-regulating organizations are subject to Commission overview and, when deemed appropriate, Commission alteration. "The Commission may also abrogate any rule of a registered association if * * * it concludes 'that such abrogation is necessary or appropriate to assure fair dealing by the members of that association * * * or otherwise to protect investors.'" Loss, Securities Regulation, p. 1364 (1961 Ed.).

guidelines in determining the "fairness and reasonableness" of the broker's compensation.^{6/} Section 1, Rules of Fair Practice, NASD Manual, pp. 2020-2034 (CCH Ed.). These rules also govern commission rates on open-end mutual funds since such sales are treated as the continuous offering of new securities. Similar controls are imposed by the NASD over the amount of markup in over-the-counter transactions. Section 4, Rules of Fair Practice, NASD Manual, pp. 2054-2058 (CCH Ed.).

What is "a fair commission" will depend upon "all relevant circumstances."^{7/} Section 4, Rules of Fair Practice, NASD Manual, p. 2054 (CCH Ed.). Substantially different quantum of effort are required when a broker takes an order for the purchase of 100 shares of General Electric than in connection with the sale for investment of \$5,000 of a mutual fund, the sale of an interest in a real estate syndication, or the sale of 100 shares in a new enterprise. These differences have given rise to substantial differences between the commission rate on new underwritings and mutual funds, on the one hand, and listed securities, on the other. Moreover, to the extent that the record in this case touches upon the subject at all, it shows that substantial time and effort went into financial planning cases. The potential financial planning client was first interviewed, usually at his home or office. If he agreed to give further consideration to financial planning, comprehensive financial and personal information was obtained, this information was analyzed by the representatives (in conjunction with a supervisor if the representative had less than one year's experience), a presentation of a proposed plan was then made to the prospective client, and only then would a specific securities

^{6/} In making such determinations, the Committee on Corporate Finance does not look only at the rate of commission. The NASD Rules also require consideration to other aspects of "compensation" such as warrants.

^{7/} See also Klein v. SEC (2 Cir. 1955), 224 F.2d 861, involving a 50% commission rate on oil royalties.

transaction be proposed. If this process resulted in a \$5,000 mutual fund sale, with a resulting commission to the salesman of approximately \$200, this could hardly be said to be a "self-enriching" disregard of the client's interest, a conclusion reached by the Commission not by findings based on evidence,^{8/} but by ipse dixit.

The sales commissions charged by respondents were "fair and reasonable" and hence proper as a matter of law. The SEC's characterization of these commissions as "high" cannot convert that which is lawful conduct into that which is unlawful. And since the other ingredients of illegality, i.e., non-disclosure of the amount of commission rates or unsuitability of the securities recommended, were not found in this case, the so-called "scheme" found by the Commission does not constitute a violation of law.

B. Alleged Fraudulent Statements With Respect to the Sale of Securities

The Commission found that registrant and certain of the individual respondents made false statements with respect to the sale of five specified securities (Op. at 15-20; J.A. 324-329). With the exception of Van Pak (Op. at 15-17; J.A. 324-326), to which we now turn, petitioners Hodgdon, Haight and Kibler are not involved in these alleged violations. While we concede that the Commission could have found on the basis of conflicting testimony isolated violations with respect to Infrared, Paragon Electrical,

^{8/} Had respondents been given notice that they were accused of perpetrating a scheme to defraud through self-enriching sales of high-commission securities, they would have adduced evidence to show that it took much more time and effort for them to earn \$1,000 in commissions than they could have earned in a conventional brokerage operation; that the commission earnings of representatives of registrant (including the individual respondents) were less than the commission earnings of other securities salesmen of equivalent education and experience; that registrant made very modest profits from its business operations; and that on an overall basis, the handling of the investments of a security client of a conventional brokerage firm is generative of higher commissions than was true in the case of one of registrant's financial planning clients.

Apache Oil & Gas and Data Processing Corporation (Op. at 15-20; J.A. 326-329), the Commission's order cannot be sustained on the basis of these transactions.^{9/} Thus, on this branch of the case, the Commission's order must stand or fall on the Van Pak allegations.

We do not insist, as the Commission seems to believe, that administrative findings must contain an "over-elaboration of detail or particularization of facts" (R.Br. at 61). What we say is that there is no finding on sharply conflicting testimony with respect to Van Pak. The Hearing Examiner^{10/} did not even appear to be aware of the testimonial conflict.

C. There Was No Violation With Respect to the Sale of Unregistered Securities

The charge that petitioners violated the Act by selling unregistered securities does not turn on whether or not any fraudulent statements were made in connection with the sale of those securities.^{11/} Thus, the issue on this branch of the case turns solely on an issue of law--were the securities

^{9/} The Commission's imposition of the ultimate sanction rested on the totality of the violations which it found. (Op. at 26-28; J.A. 335-337). Since an agency's order must stand or fall on the grounds which it gave for its action (SEC v. Chenery Corp., 318 U.S. 80, 87, 95 (1943); 332 U.S. 194, 196 (1947)), the order must be set aside if any of the charges are defective. E.g., Carey v. C.A.B., 275 F.2d 518, 522 (1 Cir. 1960).

^{10/} One of the vices of an overly broad proceeding such as this is illustrated by this lapse. No doubt during the twenty months that the Examiner required to prepare his initial opinion, portions of the 13,000-page transcript simply escaped him. The fact that the Hearing Examiner had an opportunity to observe the demeanor of witnesses (Op. at 17; J.A. 326) does not mean that he made a finding on credibility. And, as we have shown (Br. at 60), such a finding is required as a matter of law.

^{11/} It is unlawful to make a fraudulent statement in connection with the sale of a security whether that security is registered or not. We have separately dealt with the alleged fraudulent statements charge, supra, pp. 14-15.

involved exempt from registration at the time petitioners sold them?

In an effort to avoid the effect of the 1946 publication in the Federal Register, the Commission's counsel argue: (1) that the publication was "promulgated without notice and opportunity for public comment and without the explicit endorsement of the Commission"; (2) that the publication is "not a Commission 'rule' or 'regulation' but an expression of staff views"; and (3) that, in any event, the offerings involved in this case were extraordinary and thus without the scope of the publication (Br. at 64, n. 59). We respond seriatim.

The notice and opportunity for public comment proviso of the Administrative Procedure Act explicitly excludes "interpretative rules, [and] general statements of policy." 5 U.S.C. §553(b)(3)(A). Thus, we fail to appreciate the significance of the Commission's observation that this publication was not preceded by notice and opportunity for comment.

The suggestion that the publication was "without the explicit endorsement of the Commission" is reckless and irresponsible advocacy. The 1946 publication is part of a 90-page release of interpretative rules and regulations under each of the various statutes administered by the Commission. 11 Fed.Reg. 10912-10998 (1946). The publication was submitted by the "Executive Assistant to the Commission." 11 Fed.Reg. 10998. And the document is prefaced by the following notation:

"The interpretative opinions included herein are opinions issued in the past for the guidance of the public by members of the Commission's staff (or in a few instances by the Commission) and heretofore made public pursuant to Commission authorization." 11 Fed.Reg. 10946, n. 1 (emphasis supplied).

If more be needed, we point to the added statement: "It is believed that such publication may be helpful to the public and that it falls within the

spirit of the Administrative Procedure Act." Ibid. To suggest, as the Commission's attorneys do here, that the publication was promulgated without the "explicit endorsement of the Commission" is to ignore not only the text of the document itself, but the very explicit statutory presumption that a document published in the Federal Register was "duly issued, prescribed, or promulgated." 44 U.S.C. §1507(1) (1970), formerly 44 U.S.C. §307 (1964). The only documents which may be published in the Federal Register are those "issued, prescribed, or promulgated by a Federal agency"--not its staff. 44 U.S.C. §1501 (1970), formerly 44 U.S.C. §304 (1964).

The suggestion that this publication "was not a Commission 'rule' or 'regulation' but an expression of staff views" (Br. at 64, n. 59) is to overlook the holding of the Supreme Court in Columbia Broadcasting System v. United States, 316 U.S. 407, 422 (1942), and the definition of a "rule" as set forth in Section 2 of the Administrative Procedure Act, 5 U.S.C. §1001 (1964), now 5 U.S.C. §551(1)(4) (1967). As CBS makes clear, the title placed on a document is not dispositive of its legal effect, and the Administrative Procedure Act explicitly defines a "rule" as the "whole or a part of an agency statement of general or particular applicability * * * designed to implement, interpret, or prescribe law or policy * * * " (emphasis supplied). Moreover, if, as the Commission's attorneys now seem to assert, the document was not an "order, regulation, rule * * * notice, or similar instrument," it should not have been published in the Federal Register. Those are the only kinds of documents eligible for publication, 44 U.S.C. §304 (1964),^{12/} and former Section 5(b) of that Act, in effect when this document was published, explicitly prohibits the publication of "comments or news items of any character whatsoever." 44 U.S.C. §305(b) (1964). That is why the courts have uni-

^{12/} The 1968 amendments to the Federal Register Act now set forth slightly different publication criteria. 44 U.S.C. §1505 (1970).

formly held that publication of a statement of general applicability in the Federal Register confers upon that statement the full force and effect of statutory law and binds the agency which promulgated it. E.g., Sheridan-Wyoming Coal Co. v. Krug, 84 U.S.App.D.C. 288, 172 F.2d 282, 287 (1949), rev'd on other grounds, 338 U.S. 621 (1950); Rural Electrification Administration v. Northern States Power Co., 373 F.2d 686, 691 (8 Cir. 1967). Thus, even though the rule need not have been published in the first instance, and even if it might properly have been amended to impose more (or less) strict standards, it controls all transactions occurring while it is in effect. E.g., Service v. Dulles, 354 U.S. 363 (1957); Consumers Power Co., 6 S.E.C. 444, 456-458 (1939) (per Chairman Frank).

Lest we be misunderstood, we wish to make crystal clear that our argument is predicated on the state of the law as it existed in 1960 and 1961 when the challenged transactions took place. We agree that under Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119 (1953), the Commission would have been empowered to adopt a standard which did not turn on the number of offerees. Our argument is that at the time of the offerings in question it had not done so and, as the Supreme Court pointed out--citing the very rule on which we rely, and which the Solicitor General had construed in the Commission's brief as exempting bona fide offers to less than 25 persons--"nothing prevents the Commission, in enforcing the statute, from using some kind of a numerical test in deciding when to investigate particular exemption claims." 346 U.S. at 125-126, n. 12.

As the Commission now suggests (R.Br. at 64, n. 59), the 1946 regulation does not bind the Commission to the 25-offeree test. Petitioners would nevertheless be entitled to the "good faith defense" provided by Section 19 of the Securities Act, 15 U.S.C. §77s(a). Petitioners can hardly be faulted for accepting and relying on a construction of the interpretative rule which

had been accepted by the leading scholar in the securities field,^{13/} the Congress of the United States,^{14/} a member of the Commission itself,^{15/} a prominent member of the securities bar^{16/} and a federal court.^{17/} Thus, whether or not the 1946 rule has been "superseded" by a 1962 release (R.Br. at 64, n. 49)^{18/} is beside the point. Section 19 of the Act exempts petitioners from liability for "any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason." And, as we have shown, in 1960 and 1961, when these transactions took place, petitioners relied on the prevailing interpretation of the private offering exemption. That the Commission adopted a more stringent interpretation a year later is a fact that has no bearing on this case.

D. The Record-Keeping Violations

General Counsel chides "petitioners" for failing "to comply with even the simplest recordkeeping" requirements under applicable Commission rules (R.Br. 2). However, the record shows a pattern of diligent compliance with broker-dealer reporting requirements and that registrant's failure to file amendments in the few instances at issue was totally inadvertent. With

^{13/} I Loss, Securities Regulation 664 (1961).

^{14/} H.R.Rep.No. 1542, 83rd Cong. 2d Sess. 19 (1954).

^{15/} Orrick, Some Observations on the Administration of the Securities Laws, 42 Minn.L.Rev. 25, 33 (1957).

^{16/} Brenner, Selected Jury Instruction Forms in an SEC Criminal Case, 41 F.R.D. 93, 105 (1967).

^{17/} Collier v. Mikel Drilling Co., 183 F.Supp. 104, 111-112 (D.Minn. 1958).

^{18/} It is arguable that the 1946 rule is still in effect, for the Commission republished that rule this year. 17 C.F.R., Part 231 (1971).

regard to registrant's failure to promptly transmit funds to an issuer, it was admitted that this was a single exception to years of scrupulous compliance and that this one lapse occurred during a period of extraordinary back-office stress caused by conversion to computerized operations.

Moreover, the Commission's opinion shows that no individual petitioner was found to have participated in registrant's failure to transmit funds promptly, and only petitioner Hodgdon was found to have "aided and abetted" the failure to amend the application for broker-dealer registration (J.A. 331). The only reason that Hodgdon was found to have "aided and abetted" in this latter violation was because it was his secretary who had failed to follow his instructions.

Finally, the implication that violations of this nature justify lifetime bars from the securities industry is chillingly reminiscent of "Les Miserables."

II.

On the sanction phase of the case, the Commission contends that it "gave no consideration to the vigor with which petitioners defended themselves or the amount of time consumed by the proceedings" (R.Br. at 83) in the imposition of a sanction. Additionally, the Commission contends that it was not required to consider post-1964 conduct in imposing a remedial sanction in 1971 (R.Br. at 75-78; 84-86).

1. It is sheer sophistry to suggest that the Commission did not take into account the "pragmatic considerations" (Op. at 27; J.A. 336) that it said it did. When the Commission said that respondents who settled their cases rather than litigate were entitled to "pragmatic consideration," it clearly also said that respondents, such as petitioners, who do not settle their cases are not entitled to the same "pragmatic consideration." The

situation is identical to United States v. Wiley, 267 F.2d 453 (7 Cir. 1959); 278 F.2d 500 (7 Cir. 1960). In Wiley, the trial judge said:

"Had there been a plea of guilty in this case, probably probation might have been considered under certain terms, but you are all well aware of the standing policy here that once a defendant stands trial that element of grace is removed from the consideration of the Court in the imposition of sentence" 267 F.2d at 458.

That is exactly what the Commission said here, and just as in Wiley

"a realistic appraisal of the situation compels the conclusion that [petitioners'] comparatively severe sentence was due to the fact that [they] stood trial" 278 F.2d at 500 (concurring opinion).^{19/}

2. The Commission implicitly concedes that its orders must be prospectively remedial, not retrospectively penal. Ironically, it seeks to justify its refusal to consider post-1964 conduct on the ground that it would "unduly prolong the proceeding" (Op. at 27 and n. 48; J.A. 336). In view of the inordinate delay--principally caused by the blunderbuss order for proceedings--this ruling simply cannot withstand judicial scrutiny. Where, as here, an agency requires nearly four years to dispose of a case after the record was closed, we think its public interest finding cannot stand in the face of petitioners' timely motions to update the record.^{20/}

^{19/} Contrary to the Commission, we do not think that "significantly different principles apply" (R.Br. at 83, n. 83). Petitioners, no less than a criminal defendant, had both a statutory and constitutional right to a trial-type hearing.

^{20/} The Commission's appellate attorneys refer to a recent order of the National Association of Securities Dealers (NASD) as justification for the Commission's refusal to update the record (R.Br. at 78, n. 75). We think this reference, completely dehors the administrative record, ought to be stricken. Not only is there no basis for this Court to take judicial notice of NASD proceedings, the NASD order was entered long after the Commission had entered the order under review here and thus could not conceivably have had any bearing in this case. Nevertheless, since the Commission's attorneys have seen fit to interject non-record material, we feel compelled to reply.

In March, 1970 the NASD charged registrant with selling securities to customers as principal at prices which were unfair considering all relevant circumstances,

(Continued)

Conclusion

By reason of the foregoing, the Commission's order imposing sanctions should be reversed and the administrative proceeding should be dismissed.

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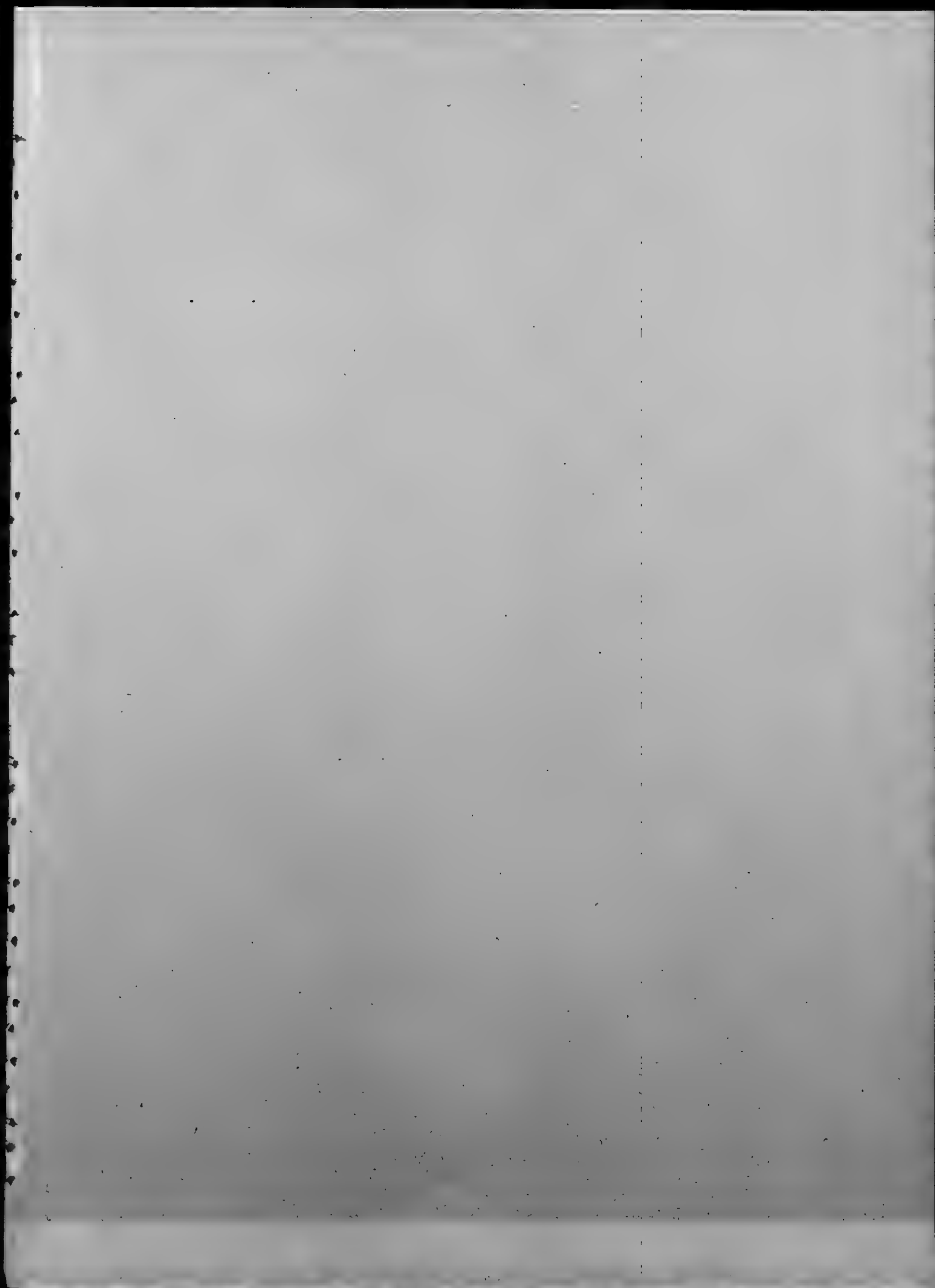
20/ (Continued)

with executing sales in two securities in which petitioner had fails to deliver which were 120 days or older, with having fails to deliver and fails to receive of 120 days or older and with failing to submit monthly reports on fails to deliver and fails to receive. The NASD based its charge that registrant had sold securities at prices which were unfair on a schedule of transactions petitioner had entered into during an eight-day period in certain securities. Notwithstanding the fact that the NASD's chart made no reference to the time of day at which the transactions were entered into, the NASD contended that particular transactions were effected at unfair prices when compared with the prices of certain other transactions.

Registrant submitted a detailed answer to the National Association of Securities Dealers' charges and pointed out, inter alia, that the time differential between the transactions precluded the comparisons which the NASD sought to make. Registrant also demonstrated with regard to securities which it had allegedly failed to deliver that it had done everything possible to effect delivery and that delivery was also prevented only because the receiving broker disputed the transaction. Registrant answered the other charges in the complaint as well.

After discussing the matter with the NASD's staff, registrant offered to settle the case. In the offer of settlement, registrant denied all of the allegations of the complaint except that which charged it with having failed to file certain reports as required by the NASD's Emergency Rules. Registrant consented to the imposition of a fine not to exceed \$2,000, a sum which would have been exceeded by the costs of the hearing registrant had requested to further respond to the NASD's complaint, and a censure if in the opinion of the NASD a censure was warranted by the violation admitted.

Relitigation of the NASD case is clearly beyond the scope of these appeals. Suffice to say, as the Commission itself concedes (R.Br. at 83), settlement cases do not ordinarily involve admissions of liability and no administrative record is made.



United States Court of Appeals
for the District of Columbia Circuit

FILED JUL 13 1971

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Nathan J. Paulson
CLERK

Nos.
71-1136
23,244
23,246

HAIGHT & CO., INC., ET AL.,

Petitioners,

-v-

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR REHEARING

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Of Counsel



UNITED STATES COURT OF APPEALS
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SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR REHEARING

The decision of this Court, affirming that of the Commission, bars petitioners from the securities industry for life. Its seriousness to them, therefore, cannot be overestimated. Cf. Greene v. McElroy, 360 U.S. 474, 492. In order to protect their livelihood petitioners invoked

the jurisdiction of this Court to obtain the judicial review of administrative action which is an essential element of the integrity of the administrative process and preservation of the rule of law. Petitioners painstakingly winnowed out all but the most significant issues of fact and law which arose in the lengthy proceedings before the Commission.

The Commission's decision departed materially from the case which was tried under the order for proceedings. Yet this Court affirms the Commission's order without opinion. Petitioners therefore do not know what issues of fact or of law this Court regarded as dispositive or even whether the order against them was sustained on the basis of the reasoning in the Commission's decision. We earnestly submit that, given the complexity of the proceedings, the substantiality of the issues of law raised and the gravity of the consequences to these petitioners, affirmance without opinion did not give these petitioners the judicial review to which they were entitled under the statute.

This Court has frequently admonished administrative agencies that they must articulate the basis of their decisions in order that judicial review can be meaningful. But

a similar obligation to that which the administrative agencies owe to the appellate courts is owed in turn by those courts to the Supreme Court. For the Supreme Court also has a reviewing responsibility in administrative proceedings. Of course, the Supreme Court's review is not of the same nature as that of this Court. Ordinarily, a Court of Appeals' determination whether there was substantial evidence to support the administrative finding will not be further reviewed by the Supreme Court. See e.g., NLRB v. Pittsburgh Steamship Co., 340 U.S. 498. And so, where the Court is satisfied that the only issues in the review proceeding are factual, and the Court so states, elaboration of its views will not normally be necessary in order that the Supreme Court may perform its function. However, where questions of law are raised by the party which seeks review of agency action, the Supreme Court does have a role to play, and its determination whether to exercise its discretionary jurisdiction will depend on the importance and substantiality of those legal questions or whether there appears to be a conflict in the manner in which several Courts of Appeals have decided the

questions presented.^{1/} In other words, the Courts of Appeals perform an important function for the Supreme Court in review proceedings; but this contemplates an opinion which advises the Supreme Court of the basis of the Court of Appeals' conclusion.

We submit that the Court cannot fulfill these responsibilities by deciding, without opinion, a case which calls into play so many aspects of judicial review. Greater Boston Television Corp. v. FCC, C.A.D.C. Case Nos. 17,785, et al., decided November 13, 1970, slip op. pp. 15-21. Particularly where the case is complex both in fact and in law, articulation of the basis of decision is necessary so that the agency and the public as well as the aggrieved party know exactly what has been decided. Where a case turns only on its own facts, and has no precedential value, a disposition without opinion may be a justifiable husbanding of judicial

^{1/} The agency whose order was approved by the Court of Appeals can be expected to argue, in any case in which such a contention is colorable, that the Court of Appeals affirmed on factual grounds alone and that therefore there is no further occasion for review by the Supreme Court. In the absence of an opinion by the Court of Appeals the Supreme Court determines whether this is correct only by an independent examination of the record, which absorbs greater judicial energies than should be required in passing on a petition for certiorari.

resources. But even in such a case, the failure to write an opinion deprives the Court of the benefit which expressing the Court's impression on paper has on the process of decision itself. As Judge Frank said:

"Often a strong impression that, on the basis of the evidence, the facts are thus-and-so gives way when it comes to expressing that impression on paper."
United States v. Forness, 125 F.2d 928, 942 (C.A. 2), cert. denied, City of Salamanca v. U.S., 316 U.S. 694, 62 S. Ct. 1293, 86 L.Ed. 1764 (1942), cited with approval in Robey v. Schwab, U.S. App. D.C. , 307 F.2d 198, 202 n. 13.

One of the major issues raised by the petition for review was that the Commission went far outside the order for public proceedings to find that respondents had violated the securities laws. That same issue was presented in Jaffee & Company v. Securities and Exchange Commission, a case which was decided by the Court of Appeals for the Second Circuit on June 18, 1971 (a copy of the slip opinion is annexed hereto). Had that opinion been available to counsel for petitioners

prior to the entry of judgment, it would have been called to the attention of the Court, for its holding is directly pertinent to the notice issue presented here. The Court of Appeals for the Second Circuit held:

"Although the complaint mentioned that Jaffee was then a partner of Jaffee & Co., a reasonable construction of the gist of the complaint would have been that Jaffee & Co. had itself committed violations of the securities acts, not that the Commission contemplated only derivative liability. The omnibus citation in the order of hearing to §15(b), a provision which as codified includes ten subdivisions and consumes three pages in the United States Code Annotated, see 15 U.S.C.A. §78o(b), would hardly have alerted Jaffee & Co. to the possibility it would incur derivative sanctions. This is particularly true in view of the fact that Section 15(b) would also have served as the natural vehicle for disciplining Jaffee & Co. directly for its own infractions, if such infractions had been found.

"Moreover, as is apparent from the hearing examiner's conclusion that Jaffee & Co. had been insufficiently notified of any potential derivative liability, the hearing itself so far as it involved Jaffee & Co. was concerned exclusively with questions bearing on whether it should be charged with alleged wrongs committed by the Leverton firm. Indeed, although the potential for derivative sanctions was of course inherent in the facts of the case from the outset, the Division apparently never suggested that the Commission actually rely on §15(b)(5) for that purpose until it made the suggestion in a brief filed with the examiner after the conclusion of the hearing before him. Accordingly, although considerable evidence was introduced at the hearing by both sides concerning the

relation between Jaffee & Co. and Leverton, and concerning Leverton's activities during the relative period, no consideration whatever was given to possible derivative sanctions. An absence of evidence bearing on the propriety of such sanctions would appropriately have been expected had Jaffee & Co. been properly notified of the possibility they would be imposed. As the Commission's own brief before us on this appeal spells out at some length, the decision whether to invoke the sweeping power to impose essentially "no-fault" liability on a firm pursuant to §15(b)(5) is a complex and delicate one, requiring the careful weighing of detailed evidence bearing on the relationship between the infractor and the firm to be penalized derivatively. Had Jaffee & Co. been afforded adequate notice, it would have had an opportunity, both to take action to lessen the attractiveness of invoking derivative sanctions and to introduce evidence before the hearing examiner tending to show that the use of such sanctions would not have been in the public interest. These opportunities were totally denied it by reason of the course adopted in the notice and at the Commission's hearings.

"The Commission argues that notice is always sufficient whenever an order for hearing includes somewhere within its four corners a reference, however veiled and indistinct, to the facts and law which together would support the liability ultimately imposed. But such a mechanistic approach to the notice and hearing requirements of Section 15(b)(5) ignores the interrelationship between those two requirements and thus elevates form over function. As in other similar contexts, a primary purpose of the notice requirement in this case is to permit the respondent a reasonable opportunity to prepare a defense against the theory of liability invoked by those who institute the proceedings against it. A respondent may not reasonably be expected to defend itself

against every theory of liability of punishment that might theoretically be extrapolated from a complaint or order if one were to explore every permutation of fact and law there alluded to or asserted. The Commission's proposed test would make a guessing-game of proceedings that the notice and hearing requirement are designed to rationalize.

"Thus, for the hearing requirement to have any meaning, the notice provision must be interpreted to require that respondent have "fair notice" of the claim lodged against it "and the grounds upon which it rests," Conley v. Gibson, 355 U.S. 41, 47 (1957). Particularly in view of the inherent complexity of the proceedings and the concomitant major effort on the part of Jaffee & Co. required to meet any attacks against it, the order instituting these proceedings was patently inadequate to disclose that it would ultimately be required to fight a two-front war. Having drawn all the firm's resources to the defense of the direct liability claim so elaborately limned in the order instituting the proceedings, it was improper and a breach of the notice and hearing requirements of §15(b)(5) for the Commission then to find (almost as an afterthought because it was not successful in its main thrust), that Jaffee & Co. had won a battle but lost a war it had no reason to know it was waging on a battlefield it had never entered. See In Re Ruffalo, 390 U.S. 544, 550 (1968)."

We believe that in the light of that holding, this Court should grant the petition for rehearing, vacate its judgment and vacate the order of the Commission. ^{2/} If, however,

^{2/} This was the relief granted by the Court of Appeals for the Second Circuit in Jaffee.

this Court is disinclined to adopt the ratio decidendi of the Court of Appeals for the Second Circuit it should at the very least issue an opinion dealing with the question of notice ^{3/} which would give petitioners their opportunity to seek a writ of certiorari from the Supreme Court of the United States on the basis of the clear conflict which would then exist.

Respectfully submitted,

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^{3/} We also urge that the Court, at least in summary fashion, indicate the basis for its disposition of the other issues presented by this appeal.

CERTIFICATE OF SERVICE

I hereby certify that I have this day mailed two copies of the Petition for Rehearing herein to Philip A. Loomis, Jr., Esquire, Office of the General Counsel, Securities and Exchange Commission, 500 North Capitol Street, Washington, D. C. 20549, attorney for the respondent herein.

Sidney Dickstein
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Attorney for Petitioners

Dated: July 13, 1971

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 835—September Term, 1970.

(Argued May 25, 1971

Decided June 18, 1971.)

Docket No. 34859

JAFFEE & COMPANY and WILTON L. JAFFEE, JR.,

Petitioners,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Before:

KAUFMAN, ANDERSON and MANSFIELD,*

Circuit Judges.

Petition to review an order of the Securities and Exchange Commission, 15 U.S.C. §78y(a), suspending petitioner Jaffee from being associated with a broker or dealer in securities for a period of twenty days and suspending the registration as broker-dealer of petitioner Jaffee & Co. for a concurrent period of twenty days.

With respect to Jaffee the order is affirmed; the suspension of Jaffee & Co. is set aside.

* Of the United States District Court for the Southern District of New York, sitting by designation, at time of submission.

JEROME J. LONDIN (Carro, Spanbock & Londin,
on the brief), and WILTON L. JAFFEE, JR.,
pro se, for petitioners.

RICHARD E. NATHAN, Special Counsel (Philip A.
Loomis, Jr., General Counsel; David Ferber,
Solicitor, and James J. Sexton, attorney, Se-
curities and Exchange Commission, Wash-
ington, D. C.), for respondent.

KAUFMAN, Circuit Judge:

Respondents Jaffee and Jaffee & Co., a registered broker-dealer, petition for review of an order of the Securities and Exchange Commission, dated April 20, 1970, prescribing that each petitioner be disciplined on account of Jaffee's violations of Rule 10b-6, 17 C.F.R. §240.10b-6, promulgated under Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b). We affirm the order with respect to Jaffee but hold that Jaffee & Co. was afforded inadequate notice that it would be disciplined derivatively on account of Jaffee's violations, rather than because of violations attributable directly to the Company, and hence set aside the order disciplining Jaffee & Co.

I.

None of the essential facts is in dispute. This proceeding was initiated by order of the Commission dated March 24, 1966, which directed a hearing into alleged violations of several provisions of the securities acts by several named respondents, including petitioners here.¹ All of the alleged

¹ Besides petitioners, other respondents named in the order instituting the proceedings included Greene & Co., a registered broker-dealer through

infractions related to transactions between June 1963 and March 1964 in connection with a secondary offering of common stock in Solitron Devices, Inc., a designer and manufacturer of electronic products. Following a hearing extending for 10 days, the hearing examiner found that Jaffee, while he was the dominant partner in the since defunct partnership and broker-dealer of Jaffee & Leverton, had violated Rule 10b-6 as well as Section 5(b) of the 1933 Act and various anti-fraud provisions of both the 1933 and 1934 Acts. The examiner recommended that Jaffee be suspended for thirty days but dismissed the proceedings against Jaffee & Co. on the grounds that as a successor and not a mere continuation of the Leverton firm, it could not be held accountable for any of that firm's wrongdoings, and second, that Jaffee & Co. had insufficient notice to permit the imposition of derivative sanctions under Section 15(b)(5) of the Exchange Act, 15 U.S.C. §78o(b)(5), the provision ultimately relied upon by the Commission.

The Commission granted the petitions for review which were filed by all respondents. Jaffee & Co., in light of the Examiner's favorable decision, did not petition for review. After oral argument, the S.E.C. absolved Jaffee of all but the Rule 10b-6 violations and, rejecting the hearing examiner's finding of insufficient notice, disciplined Jaffee & Co. under Section 15(b)(5) of the 1934 Act on the sole ground that at the time the proceedings were instituted and during the hearings, Jaffee's interest in the firm ex-

whom Jaffee conducted much of the trading found by the Commission to have been illegal; Greene & Co.'s general partners, Robert Topol and Irving Greene; Bernard Horn, at the relevant times a trader for Greene & Co.; and M. L. Lee & Co., a registered broker-dealer, and its president and director, Martin L. Levy. The Commission ultimately ordered that Greene & Co. and M. L. Lee & Co. be censured and that Bernard Horn be suspended from associating with a broker or dealer for thirty days.

ceeded 90%, even though the firm had not been in existence at the time Jaffee was found to have violated Rule 10b-6. Because of this disposition of the proceeding against Jaffee & Co., the SEC found it unnecessary to decide whether the firm might also be liable for any violations that may have been committed by Jaffee & Leverton, which the hearing examiner had added as an alleged participant in the various violations charged (but not as a respondent), over the objections of Jaffee & Co. The Commission ordered that Jaffee be suspended from associating with a broker or dealer and that Jaffee & Co.'s registration be suspended, each suspension to run for concurrent periods of twenty days. By order of the Commission the suspensions have been stayed pending the determination of this petition.

II.

We find no merit to Jaffee's primary arguments that he did not violate Rule 10b-6 because there was no "distribution" within the meaning of that provision in progress at the time he made several purchases of stock in Solitron; or, assuming there was a distribution, that the Commission did not show that his purchases were intentionally or actually manipulative. A registration statement for a secondary offering of 107,700 shares held by thirty-four holders of common stock in Solitron (or about 28% of the then outstanding common stock) was filed under Section 6 of the 1933 Act, 15 U.S.C. §77f, and became effective on October 11, 1962. The largest block of this stock, consisting of 27,500 shares, was Jaffee's. The prospectus announced that the selling stockholders intended to offer the stock for sale on the over-the-counter market "in the proximate future" and appointed Lee & Co., a New York broker-dealer, "exclusive agent" for the offering. Among other things,

each shareholder agreed to "comply with the provisions of Rule 10b-6."

Jaffee's liability was premised on his purchases of ten shares of Solitron on August 19, 1963 and an additional 7,600 shares at various times between December 26, 1963 and February 13, 1964. Jaffee's only sale of registered stock during this period was of a single block of 3,500 shares on October 30, 1963. As early as May, 1963, however, Lee & Co. had disposed of 16,300 shares owned by other participants in the offering and by March of the following year the total of registered stock sold had risen to 75,100 shares, or almost 75% of the total registered offering. Shortly thereafter, between October 20 and December 30, 1964, Jaffee sold an additional 16,900 shares of his registered stock.

These facts make out a clear violation of Rule 10b-6, which in relevant part prohibits any "person on whose behalf . . . a distribution is being made" or any person "who has agreed to participate or is participating in . . . a distribution . . . to bid for or purchase . . . any security which is the subject of such distribution . . . until after he has completed his participation in such distribution . . ." There are several exceptions to this prohibition, none of which Jaffee invokes to justify his purchases of Solitron. Jaffee does not dispute that had he been actively promoting the sale and had he in fact sold substantial blocks of his registered stock immediately following his purchases, he would have violated Rule 10b-6. See J. H. Goddard & Co., Securities Exchange Act Release No. 7618 (1963). Rather, Jaffee characterizes his offering under the prospectus and registration as a "shelf registration" because—whatever the intent of other participants may have been—Jaffee himself had no present intent to publicly distribute his registered stock immediately. Jaffee

seeks to excuse the 3500 shares sold in October, 1963, as an "unsolicited transaction." His related argument—related because each approach would erode the prophylactic value of the rule—is that the Commission has not shown that Jaffee intended to manipulate the market, or did in fact manipulate it, or did in fact defraud any buyer or seller through his purchases and sales.

Difficult questions may arise with respect to an *underwriter's* purchase of registered stock where he claims a bona fide intent to "shelve" or keep for investment some portion of it. See Whitney, *Rule 10b-6: The Special Study's Rediscovered Rule*, 62 Mich. L. Rev. 567 (1964); *Report of Special Study of Securities Markets of the S.E.C., H.R. Doc. No. 95, 88th Cong., 1st Sess., pt. I* at 545-46 (1963). Similarly, Rule 10b-6(c)(3) provides that a person "shall be deemed . . . to have distributed securities acquired by him for investment" (at which point Rule 10b-6 ceases to apply), a provision which gives rise to close questions with respect to when an underwriter, for example, decides to "shelve" a "sour" issue, see 3 *Loss, Securities Regulation* 1595 (2d ed. 1961). But Jaffee does not and, on this record, could not successfully contend that at any time following the effective date of the registration statement he was holding his registered stock "for investment." His very registration of shares owned by him implied an intention to sell or distribute rather than to hold them for investment. Moreover, Rule 10b-6(a)(3)(xi) provides that for the purpose of determining the liability of an underwriter and others who purchase securities within a brief specified period before the commencement of a distribution, "the distribution shall not be deemed to commence . . . prior to the effective date of the registration statement," where the securities are registered under the 1933 Act, as here. Although the last-

quoted provision does not refer to participants in a distribution generally, see *Note, The SEC's Rule 10b-6: Preserving a Competitive Market During Distributions*, 1967 Duke L.J. 809, 848-49 (1967), the use of the "effective" date of the registration statement to define the operative period of the rule is instructive here. The dangers of market manipulation that Rule 10b-6 was designed to eradicate, see *Chris Craft Industries, Inc. v. Bangor Punta Corp.*, 426 F.2d 569, 577 (1970) (*en banc*), were continually present so long as Jaffee's purchases might have artificially inflated the price of Solitron, thereby affording him an opportunity to sell his registered stock at a price higher than he would have received if the market had been permitted to seek its own level. The Commission was clearly justified in applying the rule during a period following the registration and before Jaffee had "completed his participation" in the distribution. See *R. A. Holman & Co., Inc. v. Securities and Exchange Commission*, 366 F.2d 446, 449 (2d Cir. 1966).

For similar reasons, and contrary to Jaffee's assertion, the Commission need not have shown that Jaffee actually intended to defraud the marketplace through his purchases. The rule proscribes and clearly defines a *practice* which had, prior to the adoption of the rule in 1955, been used fraudulently to distort the over-the-counter market. Where the rule applies, its prohibition is absolute. See *Note*, 1967 Duke L.J., *supra*, at 817-18. Apart from the plain language of the rule itself, a further internal index to the rule's prophylactic intent appears in its subdivision (a)(3)(xi), which excepts from the exemption there defined, purchases otherwise within the exemption which "are for the purpose of creating actual, or apparent, active trading in or raising the price of" the security in question. Jaffee in effect would have us emasculate the rule by reading

similar language into the broad prohibition of the rule itself, although the Commission's clear intent is to require actual manipulation or the like only to draw within the rule's ambit activity that would otherwise be exempted from it.²

Finally, Jaffee contends that there is no substantial evidence to support the Commission's finding either that his violation was "willful," a necessary precondition for his suspension, 15 U.S.C. §78o(b)(5)(1964), or that the purchases involved the use of the mails or an instrumentality of interstate commerce, 17 C.F.R. §240.10b-5(a)(3). But as our recitation of the undisputed facts shows, Jaffee clearly intended to commit "the act which constitutes the violation," *Tager v. Securities and Exchange Commission*, 344 F.2d 5 (1965), which is all that is required in this context. And most of Jaffee's purchases were effected through the broker-dealer Greene & Co., see note 2, *supra*, which at Jaffee's instance placed bids for Solitron stock in the "pink sheets" distributed in interstate commerce by the National Daily Quotations Bureau. The insertion of bids in the sheets is sufficient support for the SEC's jurisdiction. "The use of the mails . . . may be entirely incidental" to the scheme that is the basis for liability, *United States v. Cashin*, 281 F.2d 669, 673 (2d Cir. 1960), and

2 Moreover, there is substantial evidence in the record to support the Commission's finding that the broker-dealer Greene & Co., which effected the bulk of Jaffee's purchases, was engaged in market-making activities in Solitron throughout the relevant period. During this same period, Greene & Co. purchased as principal through Bernard Horn, a trader for Greene & Co., 25,000 shares of registered Solitron stock for its own account. Jaffee admitted that prior to the period during which he was making purchases of Solitron, but after the effective date of the registration, he asked Horn to "go into" the "pink sheets" distributed by the National Quotation Bureau, Inc. Thereafter Greene & Co. continuously did insert bids in the quotation sheets. These facts amply refute the core of Jaffee's theory, which is that the dangers Rule 10b-6 were designed to avert were not inherent in Jaffee's activities.

the use here is better described as integral to the scheme than as merely incidental.³

III.

This brings us to the telling argument urged by Jaffee & Co. Jaffee & Co. was disciplined, as we have already indicated, pursuant to Section 15(b)(5) of the Securities and Exchange Act, 15 U.S.C. §78o(b)(5). This section permits the Commission, in relevant part, to suspend the registration of a broker or dealer if it finds that the suspension "is in the public interest" and that a "person associated" with the broker or dealer, "whether prior or subsequent to becoming so associated," willfully violated any provisions of various securities laws, including the 1934 Act, or "any rule or regulation under such statutes." *Id.* §78o(b)(5)(D). As we have held, Jaffee was properly found to have willfully violated Rule 10b-6. Furthermore, Jaffee was clearly a person "associated" with Jaffee & Co., as that term is defined in 15 U.S.C. §78c(a)(18) to include both "partners" and "controlling" persons, by virtue of the firm's partnership agreement dated December 23, 1964 and effective January 1, 1965. As amended April 1, 1966, that agreement named Jaffee and Kenneth Rich as the two partners in the firm. Jaffee contributed \$195,000 of the firm's \$200,000 cash capital as well as his Stock

3 We also find no error in the Commission's denial of Jaffee's requests for access to various reports and other material in the files of the Commission including statements made to the Commission by investors in Solitron and an S.E.C. file concerning its negotiations with respect to the mechanics of the October 11, 1962, registration of the Solitron offering. None of this material was available under Rule 11.1 of the Commission's Rules of Practice, 17 C.F.R. §201.11.1, which incorporates the substance of the Jencks Act, 18 U.S.C. §3500. Nor is there any indication that the undisclosed material might have been favorable, or even relevant, to Jaffee's defense. See *United States v. Andolschek*, 142 F.2d 503, 506 (2d Cir. 1944).

Exchange seat, valued at \$200,000. Of the firm's net profits on "general business," Jaffee was to receive 94% while Rich's share was only 1%. The firm's losses were to fall with comparably lopsided disproportion: 99% on Jaffee and 1% on Rich. Thus, although Jaffee last transacted an illegitimate purchase of Solitron about 11 months before Jaffee & Co. came into being, §15(b)(5) at least by its terms was a serviceable device for suspending Jaffee & Co. derivatively for Jaffee's prior wrongs.

A precondition to revocation, however, was that Jaffee & Co. be afforded "appropriate notice and opportunity for hearing," 15 U.S.C. §78o(b)(5); see also 5 U.S.C. §554(b). We conclude that with respect to Jaffee & Co.'s derivative §15(b)(5) liability, neither condition was met in the proceedings before the Commission.

The order instituting the proceedings in its first paragraph identified Jaffee & Co. as a *continuation* of and as legally indistinguishable from the firm of Jaffee & Leverton, with which Jaffee had been associated at the times of his violations of Rule 10b-6.⁴ Paragraphs II.8-D of the order recited that the Commission's Division of Trading and Markets alleged that Jaffee & Co., along with other respondents, had *itself* violated various provisions of the securities acts, including Rule 10b-6. Clearly (since Jaffee & Co. did not exist in name at the time of the violations), the Division had in mind violations by the Leverton firm, which it considered as one with Jaffee & Co. Finally, in part III of the order the Commission broadly defined the purpose of the proceedings instituted as to determine ap-

⁴ The Commission alleged that "Jaffee & Co., formerly known as Jaffee & Leverton . . . has been registered as a broker-dealer . . . since May 19, 1963 and is still so registered." May 19, 1963 was the date of the Leverton firm's registration. Jaffee & Co.'s registration was effective January 1, 1965.

appropriate remedial action, based on the infractions alleged in part II, "pursuant to Sections 15(b), 15A, and 19(a)(3) of the Exchange Act."

Although the complaint mentioned that Jaffee was then a partner of Jaffee & Co., a reasonable construction of the gist of the complaint would have been that Jaffee & Co. had itself committed violations of the securities acts, not that the Commission contemplated only derivative liability. The omnibus citation in the order of hearing to §15(b), a provision which as codified includes ten subdivisions and consumes three pages in the United States Code Annotated, see 15 U.S.C.A. §78o(b), would hardly have alerted Jaffee & Co. to the possibility it would incur derivative sanctions. This is particularly true in view of the fact that Section 15(b) would also have served as the natural vehicle for disciplining Jaffee & Co. directly for its own infractions, if such infractions had been found.

Moreover, as is apparent from the hearing examiner's conclusion that Jaffee & Co. had been insufficiently notified of any potential derivative liability, the hearing itself so far as it involved Jaffee & Co. was concerned exclusively with questions bearing on whether it should be charged with alleged wrongs committed by the Leverton firm. Indeed, although the potential for derivative sanctions was of course inherent in the facts of the case from the outset, the Division apparently never suggested that the Commission actually rely on §15(b)(5) for that purpose until it made the suggestion in a brief filed with the examiner after the conclusion of the hearing before him. Accordingly, although considerable evidence was introduced at the hearing by both sides concerning the relation between Jaffee & Co. and Leverton, and concerning Leverton's activities during the relative period, no consideration what-

ever was given to possible derivative sanctions. An absence of evidence bearing on the propriety of such sanctions would appropriately have been expected had Jaffee & Co. been properly notified of the possibility they would be imposed. As the Commission's own brief before us on this appeal spells out at some length, the decision whether to invoke the sweeping power to impose essentially "no-fault" liability on a firm pursuant to §15(b)(5) is a complex and delicate one, requiring the careful weighing of detailed evidence bearing on the relationship between the infractor and the firm to be penalized derivatively. Had Jaffee & Co. been afforded adequate notice, it would have had an opportunity, both to take action to lessen the attractiveness of invoking derivative sanctions and to introduce evidence before the hearing examiner tending to show that the use of such sanctions would not have been in the public interest. These opportunities were totally denied it by reason of the course adopted in the notice and at the Commission's hearings.

The Commission argues that notice is always sufficient whenever an order for hearing includes somewhere within its four corners a reference, however veiled and indistinct, to the facts and law which together would support the liability ultimately imposed. But such a mechanistic approach to the notice and hearing requirements of Section 15(b)(5) ignores the interrelationship between those two requirements and thus elevates form over function. As in other similar contexts, a primary purpose of the notice requirement in this case is to permit the respondent a reasonable opportunity to prepare a defense against the theory of liability invoked by those who institute the proceedings against it. A respondent may not reasonably be expected to defend itself against every theory of liability

or punishment that might theoretically be extrapolated from a complaint or order if one were to explore every permutation of fact and law there alluded to or asserted. The Commission's proposed test would make a guessing-game of proceedings that the notice and hearing requirements are designed to rationalize.

Thus, for the hearing requirement to have any meaning, the notice provision must be interpreted to require that respondent have "fair notice" of the claim lodged against it "and the grounds upon which it rests," *Conley v. Gibson*, 355 U.S. 41, 47 (1957). Particularly in view of the inherent complexity of the proceedings and the concomitant major effort on the part of Jaffee & Co. required to meet any attacks against it, the order instituting these proceedings was patently inadequate to disclose that it would ultimately be required to fight a two-front war. Having drawn all the firm's resources to the defense of the direct liability claim so elaborately limned in the order instituting the proceedings, it was improper and a breach of the notice and hearing requirements of §15(b)(5) for the Commission then to find (almost as an afterthought because it was not successful in its main thrust), that Jaffee & Co. had won a battle but lost a war it had no reason to know it was waging on a battlefield it had never entered. See *In Re Ruffalo*, 390 U.S. 544, 550 (1968).

Accordingly, the order of the Commission is affirmed with respect to Jaffee but so much of the order as suspends the registration of Jaffee & Co. is vacated.